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IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

THE EL PASO COMPANY,
Petitioner,

v.

UNITED STATES OF AMERICA, *et al.*,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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QUESTIONS PRESENTED

1. Whether the court below erred in holding, contrary to decisions of other Circuit Courts, that a company's "tax pool analysis" is relevant under 26 U.S.C. § 7602 to an Internal Revenue Service investigation of the company's tax returns, even though the analysis was not used in preparing the returns, consists exclusively of speculation and opinion concerning potential tax issues, negotiations, and litigation the company may face, and was developed for purposes of assessing and reporting the company's contingent tax liability as required by the securities laws.

2. Whether the court below erred in holding, contrary to decisions in other Circuit Courts, that a company's tax pool analysis and its discussions relating thereto are not privileged, under either the attorney-client privilege or the work-product doctrine, even though the analysis was prepared by and in consultation with the company's attorneys and was confidentially discussed with its independent auditors for purposes of complying with the securities laws.

PARTIES TO THE PROCEEDINGS *

The parties before the United States Court of Appeals for the Fifth Circuit were the United States of America and Revenue Agents Clarence H. Isbel and John S. Reid of the Internal Revenue Service, Petitioners-Appellees, and The El Paso Company, Respondent-Appellant.

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* Petitioner, The El Paso Company, reports, pursuant to Rule 28.1 of the Rules of this Court, that it is a parent company and that its subsidiaries (except wholly owned subsidiaries) and affiliates are as follows:

El Paso Natural Gas Company
Geonuclear Nobel Paso
Minera San Pedro Corralitos, S.A.
Windjammer, Inc.

The following companies are owned by a partnership which consists of Desert American Agency, Inc. (a wholly-owned subsidiary of the El Paso group) and Hartford Insurance Company:

A.I.A. Corporation
Desert American Insurance Agency-Colorado, Ltd.
(owned 50% by the partnership)
Desert American Insurance Agency, Inc.-Arizona
Desert American Insurance Agency, Inc.-California
Desert American Insurance Agency, Inc.-New Mexico
Desert American Insurance Agency, Inc.-Virginia
(owned 50% by the partnership)

The following are joint ventures in which the El Paso group owns an interest:

Lake Country
Adams Canyon Ranch
Santa Paula Farms
La Salle Terminal Company
Dart-El Paso Polyolefins-El Paso Products

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OPINIONS BELOW

The majority and dissenting opinions of the Court of Appeals (App. 1a-42a) are reported at 682 F.2d 530. The judgment of the Court of Appeals (App. 59a-60a), entered September 30, 1982, affirming the judgment of the District Court, is unreported. The opinion of the District Court (App. 43a-58a) is unreported. The judgment of the District Court (App. 63a-65a), entered November 30, 1981, ordering compliance with the Internal Revenue Service summonses, is unreported.

JURISDICTION

The judgment of the Court of Appeals was entered on September 30, 1982. The Petition for Rehearing and Suggestion for Rehearing En Banc, both timely filed, were denied on September 18, 1982. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTE INVOLVED

26 U.S.C. § 7602

> For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability, the Secretary is authorized—
>
> (1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry;
>
> (2) To summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary may deem proper, to appear before the Secretary at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry; and
>
> (3) To take such testimony of the person concerned, under oath, as may be relevant or material to such inquiry.

STATEMENT OF THE CASE

On February 13, 1980, the Internal Revenue Service ("IRS") issued a summons pursuant to 26 U.S.C. § 7602 to The El Paso Company ("El Paso" or "the Company") in connection with a routine examination of the Company's tax returns for the years 1976 through 1978.[1] The summons directed El Paso to produce:

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[1] A second summons sought "[a]ll internal audit reports, including all related workpapers and logs of such reports," for the same period. Since El Paso complied with this summons, it is not before the Court for consideration. App. 8a n.1.

> Any document, memorandum, letter or workpapers which identify potential tax liabilities or tax problems for the period beginning January 1, 1976, and ending December 31, 1978, inclusive. [App. 66a.]

El Paso appeared at the time stated in the summons, but declined to comply, producing instead a letter stating its reasons for believing compliance was not required. App. 68a-71a.[2] The principal reasons stated therein that are germane to this Petition were that the documents sought were not relevant or material to any legitimate IRS inquiry, and that the documents were in any event privileged. Before describing the lower courts' treatment of these questions, and thereafter the reasons why we believe this Court should now consider those questions, it will be helpful if we first describe the documents at issue.

The Tax Pool Analysis

Each year at the direction of and in consultation with their in-house legal counsel, El Paso tax compliance personnel prepare an analysis of the Company's future potential tax liability. TR., Vol. II, at 33-35. In summary, this analysis—the "tax pool analysis"[3]—reflects the Company's best estimate of what the tax liability for that particular year will be after all potential or pending tax audits, refund claims, negotiations, and litigation are finally settled or concluded.[4] TR., Vol. II, at 33. More spe-

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[2] El Paso acted in good faith. As of August 1981 it had complied with, or was in the process of complying with, over 98 percent of some 578 Information Document Requests. Transcript of Summons Enforcement Hearing before the United States District Court for the Southern District of Texas, Vol. II, at 80-82 (hereinafter cited as "TR.").

[3] The term "tax pool analysis" is generally regarded as synonymous with the terms "tax accrual workpapers" and "contingent tax liability workpapers." *See* I Internal Revenue Manual (Audit) (CCH) § 4024.2(3) (1981).

[4] *See also* I Internal Revenue Manual (Audit) (CCH) § 232.8(4) (1981) (recognizing that such an analysis is based upon opinions

cifically, development of the tax pool analysis serves to: (1) identify issues on the Company's federal tax returns which counsel and other tax compliance personnel think could be subject to challenge in the course of an audit because of differences with the IRS on interpretation of law or characterization of fact; (2) speculate on the likelihood that the IRS will raise these issues; (3) evaluate whether the Company would litigate the issues raised and estimate its chances of prevailing; (4) review and evaluate the legal implications of the issues identified; (5) estimate the dollar amounts for which the Company would be willing to settle each controversy administratively if it chose not to litigate; and (6) assign a total estimated dollar amount to the aggregate outcome as to all issues discussed. *See* TR., Vol. II, at 33-36, 89-94, 139-40.

As expressly recognized by the lower court, the described tax pool analysis is not used in any way to assist in preparation of the Company's tax returns. App. 6a. Instead, as will be explained, the analysis is prepared to assist the Company to meet its responsibilities under the federal securities laws.

The Securities and Exchange Commission ("SEC") requires public corporations subject to the securities laws to file audited financial statements periodically. *E.g.*, 15 U.S.C. § 78*l*. These financial statements must be prepared in accordance with generally accepted accounting principles which, in turn, require disclosure of any material contingent liabilities.[5] Since income tax liability is crucial to any determination of net income, the possibility of additional tax assessments commonly constitutes a material contingent liability. Hence, the inde-

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and projections of the company conveyed in confidence to an independent accountant for the purpose of developing a worst-case estimate of contingent tax liability).

[5] Regulation S-X, 17 C.F.R. §§ 210 *et seq.* (1981); American Institute of Certified Public Accountants, Statement on Auditing Standards No. 1, § 110.01 (1973); Financial Accounting Standards Board, Statement of Financial Accounting Standards No. 5 (1975).

pendent auditor who verifies a given company's financial statements must independently consider issues contained in the company's tax pool analysis—or prepare such an analysis itself if the company has not—and reach its own judgment concerning both the amount of contingent tax liability and any need for disclosure thereof in the financial statement.

As described later, any discussions of the tax pool analysis between a company and its auditors, or any documents furnished by either party in connection with the analysis, are treated by both parties as strictly confidential. In El Paso's case, while the auditor discussed with the Company certain items contained in the tax pool analysis, the auditor did not see any of the actual tax pool analysis documents. TR., Vol. II, at 131.

It is the above described documents (among others) which the IRS sought in the courts below.

The Lower Court Proceedings

On May 27, 1981, the IRS filed a petition for enforcement of its summons in the United States District Court for the Southern District of Texas pursuant to 26 U.S.C. § 7604. In response, El Paso contended that the summons was overbroad, that the documents sought were not "relevant" to any legitimate investigatory purpose within the meaning of 26 U.S.C. § 7602, and that the documents were protected by the attorney-client and work-product privileges. The District Court decided against El Paso as to each of these contentions, adopting without change the findings of fact and conclusions of law prepared by the Government. App. 43a-58a.

Since the District Court found, first, that the summons was not overbroad (App. 54a-55a), it also rejected El Paso's contention that the overbreadth effectively prevented the Company from making a particularized showing regarding which specific documents within the summons were privileged. App. 56a. This led the court to find, second, that El Paso had therefore waived "what-

ever privilege might have existed with respect to each document which is within the scope of the summons." App. 57a. The court found, moreover, that since the "substance" of the documents within the summons was either discussed with El Paso's independent auditors "or would have been discussed had the issue been raised," "[t]his refutes the confidentiality aspect of the attorney-client privilege." App. 57a.

Finally, the court rejected El Paso's contention (and the authorities supporting that contention) that the IRS is not entitled to require production of documents which are not either related to, used, or relied upon in the preparation of the taxpayer's return. Instead, the District Court concluded that the summoned documents should be produced since any burden on the Company was outweighed by the benefit to the IRS, the production was consistent with "our voluntary system of tax collection," and the IRS should be given at least the same access to the documents which the independent auditors had been given, in order to "protect the fisc." App. 54a.

On August 13, 1982, a divided Court of Appeals affirmed the District Court, although narrowing its judgment. Thus, the Court of Appeals, first, agreed with El Paso that the scope of the summons was not entirely clear; the court therefore narrowed the summons' reach to cover only the tax pool analysis and any memoranda used to prepare that analysis. App. 10a. Second, while acknowledging that the Tenth Circuit had decided to the contrary in *United States* v. *Coopers & Lybrand*, 550 F.2d 615 (1977), the court below held that the tax pool analysis was "relevant" to the IRS investigation of El Paso's tax returns. App. 10a-12a. Although conceding that there was *no* suspicion of fraud in this case, and that the IRS audit was entirely routine, undertaken because of the amount of money involved (App. 2a),[6] the majority nev-

[6] The dissenter pointed out that not even negligence was alleged by the IRS, and the Service was not seeking "to determine or dis-

ertheless concluded that the IRS was entitled to the tax pool analysis because it "may be useful to the IRS as a 'roadmap' through [the] company's tax return." App. 28a.

Finally, the court refused to find that the tax pool analysis was privileged, under either the attorney-client privilege or the work-product doctrine, even though the court acknowledged (App. 19a & n.13) that this result was incompatible with the recent decision of the Second Circuit in *United States* v. *Arthur Young & Co.*, 677 F.2d 211 (1982), *petition for cert. filed*, No. 82-687. (Oct. 20, 1982). The court specifically concluded that El Paso had waived the attorney-client privilege by discussing certain issues in the tax pool analysis with its independent auditor (App. 16a-20a), had failed to particularize sufficiently the specific items as to which it was claiming the privilege (App. 20a-21a),[7] and that the Company could not claim

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cover any information respecting the actual receipts, disbursements or transactions engaged in by El Paso, the accuracy and completeness of its records, or any other *factual* information respecting El Paso's tax liability or the correctness of its return." App. 29a; (emphasis in original) (footnote omitted). The majority in no way disputed these assertions.

[7] The Court of Appeals' faulting of El Paso's supposed failure to particularize is both incorrect and self-contradictory. It is clear that El Paso asserted the privilege with particularity from the outset as to the ledger sheets which compose the actual tax pool analysis. It is also clear that El Paso was unable to assert the privilege with specificity as to the other documents sought because the Government's summons did not identify the documents it sought with sufficient particularity. Moreover, an affidavit filed by El Paso's Vice President for Tax in this case reveals that the Company would have an impossible task in attempting to specify each document called for by the summons. Affidavit of Jack D. McCarthy, filed with Answer of Respondent (July 15, 1981). Finally, although the Court of Appeals expressly agreed that the application of the summons had to be narrowed to apply only to the tax pool analysis and any documents used to prepare that analysis, it nevertheless criticized El Paso for failing to make a particularity showing at a time when

the work-product privilege because the tax pool analysis was not prepared in anticipation of litigation. App. 21a-25a.

In his dissent, Judge Garwood agreed with the majority's narrowing of the summons' scope, but he expressly disagreed as to two of the questions now before this Court: whether the IRS demand was relevant under 26 U.S.C. § 7602 so as to compel production of the tax pool analysis, and whether El Paso's discussion of some of the materials in the analysis with its independent auditor waived the Company's attorney-client privilege as to all materials in the analysis. With regard to the statutory issue, Judge Garwood agreed with the Tenth Circuit's decision in *Coopers & Lybrand*, *supra*, and therefore concluded that the tax pool analysis was not "relevant" to the investigation of El Paso's tax returns. App. 29a-37a. With regard to the attorney-client privilege, Judge Garwood concluded that the majority's holding—that the mere discussion of *any* tax-pool-analysis matters with the independent auditors worked a waiver of the privilege—was so broad as to undermine the privilege and this Court's decision in *Upjohn Co. v. United States*, 449 U.S. 383 (1981). App. 40a. For these reasons, Judge Garwood would have reversed the District Court's decision and precluded enforcement of the summons. App. 37a, 41a.

El Paso's timely Petition for Rehearing of the majority's decision was denied on September 15, 1982. El Paso and the IRS have agreed to a stay of the judgment pending final disposition of this Petition.

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the summons was still overboard. Affidavit of Jack D. McCarthy, filed with Answer of Respondent (July 15, 1981).

If certiorari is granted, petitioner will argue that at least where the taxpayer is a multi-national corporation with offices, employees and files located throughout the world, the IRS should itself be required to be more specific in its initial demand before the taxpayer must conduct the extraordinarily burdensome, time-consuming, and expensive search that would otherwise be necessary.

REASONS FOR GRANTING THE WRIT

Introduction

This case raises the issue of the IRS' power under 26 U.S.C. § 7602 to compel a taxpayer to disgorge its theories, opinions, arguments, speculations, and self-critical analyses regarding its contingent tax liability. Against El Paso, the IRS has claimed the power to require production not only of a step-by-step guide to the Company's legal and non-legal judgments on issues in its tax return which may conceivably be subject to challenge, but also of any documents which might reveal which issues the Company would litigate if challenged, which it would settle, and the amounts for which it would be willing to settle. IRS attempts to obtain such information from El Paso and other taxpayers have precipitated a storm of controversy, as reflected in the considerable recent legal literature on this subject[8] and, more importantly, in the

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[8] *E.g.*, Caplin, *Government Access to Independent Accountants' Tax Accrual Workpapers*, 1 Va. Tax. Rev. 57 (1981); Diss & Hanson, *Tax Contingency Audit Workpapers: Current Developments, Observations, and Proposals*, 12 The Tax Advisor 104 (1981); Buchholz, *Tax Accrual File Controversy: Legal Problems Facing the Accountant*, 40th Annual N.Y.U. Institute on Federal Taxation 37-1 (1981); Note, *A Balancing Approach to the Discoverability of Accountants' Tax Liability Workpapers Under Section 7602 of the Internal Revenue Code*, 60 Wash. U.L.Q. 185 (1982); Staltenberg & Robinson, *Enforcement of Summaries in Requesting Accountants' Workpapers*, 1982 Taxes 673; Hanson & Brown, *CPA's Workpapers: The IRS Zeros In*, 152 J. Accountancy 68 (1981); Nath, *Internal Revenue Summaries for "Sensitive" Accountants' Papers*, 34 Vand. L. Rev. 1561 (1981); Garbis & Struntz, *The Second Circuit's Arthur Young Decision: A Privilege for Tax Accrual Workpapers*, 54 J. Tax 66 (1982); Caplin, *IRS Toughens its Stance on Summoning Accountants' Tax Accrual Workpapers*, 52 J. Tax. 130 (1980); Caplin, *Should the Service be Permitted to Reach Accountants' Tax Accrual Workpapers?*, 51 J. Tax. 194 (1979); Note, *Government Access to Corporate Documents and Auditors Workpapers: Shall We Include Auditors Among the Privileged Few?* 2 J. Corp. Law 349 (1977); Note, *Constraints on the Administrative Summons Power of the Internal Revenue Service*, 63 Iowa

now seriously divided decisions of the federal Circuit Courts. This division in the Circuit Courts has, in turn, caused considerable uncertainty in the administration of the tax laws, the relationship between companies and their independent auditors, the preparation of financial reports for public distribution, and the appropriate application of the attorney-client and work-product privileges. These circumstances underlie the reasons why the present Petition should be granted.

Broadly summarized, the pertinent decisions in the Circuit Courts have analyzed the scope of the IRS summons power under 26 U.S.C. § 7602 from either or both of two standpoints: (1) whether the information sought is "relevant" to a legitimate purpose of the IRS; and (2) whether the information is privileged. As will be discussed, on the issue of relevance the Fifth Circuit's decision directly conflicts with the Tenth Circuit's decision in *Coopers & Lybrand*, and implicitly conflicts with the decision of the Eighth Circuit in *United States* v. *Matras*, 487 F.2d 1271 (1973). (The Second Circuit's decision in *Arthur Young* also conflicts with *Coopers & Lybrand*.) On the issue of work-product privilege, the Fifth Circuit's decision conflicts with the *Arthur Young* decision, which is now before the Court on a Petition for a Writ of Certiorari filed by the Solicitor General. Finally, on the issue of waiver of the attorney-client privilege, the Fifth Circuit's decision conflicts with the Second Circuit's decision in *Arthur Young*, as well as the Eighth Circuit's decision in *Diversified Industries, Inc.* v. *Meredith*, 572 F.2d 596 (1977) (en banc), the Sixth Circuit's decision in *United States* v. *Upjohn*, 600 F.2d 1223 (1979), the

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L. Rev. 526 (1977); Saltzman, *What an Accountant Can Do About the Threat of an IRS Summons to Produce His Workpapers*, 17 Tax. for Accountants 208 (1976); Weinstein, *Taxpayers' Records and Accountants' Workpapers Now More Vulnerable to IRS Summons*, 17 Tax. for Accountants 4 (1976); Diss, *The IRS and Auditors' Tax Workpapers: How Far is Too Far?* Arthur Young Journal 11 (Summer 1976).

Ninth Circuit's decision in *Weil* v. *Investment/Indicators, Research & Management*, 647 F.2d 18 (1981), and the Eighth Circuit's decision in *United States* v. *Cote*, 456 F.2d 142 (1972).

As described later, these conflicting decisions of the Circuit Courts have introduced harmful uncertainties into the relationships between independent accountants and taxpayers, between taxpayers and their counsel, and between taxpayers and the IRS, and have produced the unacceptable anomaly of the IRS summons power and taxpayer privileges varying between different circuits. We respectfully submit that guidance is needed from this Court to resolve these conflicts and to clarify the law on these important federal issues.

1. The Decision Below Directly Conflicts With Decisions in Other Circuit Courts.

The Circuit Courts are now in conflict as to all three of the significant issues that might arise when the IRS seeks to compel production of documents such as a tax pool analysis: (a) whether such documents meet the "relevance" standard of 26 U.S.C. § 7602; (b) whether such documents are protected by a work-product privilege; and (c) whether the attorney-client privilege as to such documents is waived if they are discussed with or shown to independent auditors. Each of these three conflicts is described below.

A. Relevance

In *United States* v. *Powell*, 379 U.S. 48 (1964), this Court determined that the IRS must make the following showing in order to exercise its summons power under 26 U.S.C. § 7602: "that the investigation will be conducted pursuant to a legitimate purpose, that the inquiry may be relevant to the purpose, that the information sought is not already within the Commissioner's possession, * * * that the administrative steps required by the

Code have been followed * * * and that the summons be issued in good faith." 379 U.S. at 57-58. While the *Powell* formulation may have established a relevance requirement, it does not give content to that requirement, particularly in the context of this case. Numerous decisions regarding the summoning of tax pool analyses and similar taxpayer documents have attempted to supply that content, with varying and conflicting results.

The Tenth Circuit in *Coopers & Lybrand* was the first Circuit Court to address this problem in the context of a summons seeking a tax pool analysis. The court squarely held that such a tax pool analysis, which contained the private thoughts and theories of the taxpayer and its independent accountant, was not relevant to the IRS audit. Applying a balancing test, the Circuit Court, adopting the reasoning of the District Court, considered several factors in reaching its decision, including: whether the information sought consisted of opinions and theories, not facts; whether the information sought was prepared in connection with the tax return; whether the investigation was for fraud, in which case intent would be important; whether the IRS already had in its possession the basic factual material necessary to conduct the audit; whether the IRS had a realistic expectation rather than an idle hope that something might be discovered; whether the enforcement of the summons would impair the candid interchange necessary between auditor and client, thereby threatening the continued high quality of financial reporting; and whether the IRS had shown, as required by the Eighth Circuit's *Matras* decision, a specific need for the information other than its own convenience. (The adopted reasoning of the District Court appears at *United States* v. *Coopers & Lybrand*, 413 F. Supp. 942, 949-954 (D. Colo. 1975)). Observing that under the IRS' construction of relevance, *all* corporate records could be summoned *carte blanche*, the Tenth Circuit refused to enforce the summons. 550 F.2d at 621.

In *Matras*, the IRS attempted to summons the taxpayer's budget proposals for the years under examination. The budgets contained no factual material needed by the IRS to complete its examination, but would have been useful to it as a "road map" to the taxpayer's tax returns. The Eighth Circuit upheld the District Court's ruling that only records of actual transactions, not proposed budgets, are relevant to a determination of tax liability. 487 F.2d at 1275. The Circuit Court also held that the Government's underlying view of relevance was overbroad and that the term must be construed to connote more than mere convenience. Otherwise, it said, it would be hard to imagine any corporate documents that would not fall within the ambit of the term. *Id.*

The Second Circuit, on the other hand, through its opinions in *Arthur Young* and *United States* v. *Noall*, 587 F.2d 123 (1978), *cert. denied*, 441 U.S. 923 (1979), has completely rejected the Tenth Circuit's *Coopers & Lybrand* analysis and, at least implicitly, the Eighth Circuit's *Matras* analysis as well. In *Arthur Young*, the Second Circuit held that only a low threshold of relevance—that the information sought "might have thrown light upon" the correctness of the return—need be met by the IRS. 677 F.2d at 218. Under that standard, the court concluded that the tax pool analysis there at issue was relevant. However, the Second Circuit also determined, as will be explained in the next section, that even though the tax pool analysis was "relevant," it was privileged and therefore not discoverable.

The court below expressly rejected El Paso's position, which was based directly on the *Coopers & Lybrand* holding, that the documents sought by the IRS summons were not relevant to its inquiry. App. 11a. This decision therefore adds still further conflict and confusion regarding the proper standard of relevance since the result is that in

some circuits documents such as the tax pool analysis are subject to production under 26 U.S.C. § 7602 (the Fifth and the Second) and in others they are not (the Tenth and Eighth). Moreover, the conflict and confusion in this area of the law extends to the privilege question as well.

B. Work-Product Privilege

As noted above, in *Arthur Young* the Second Circuit concluded that the tax pool analysis there in question was relevant; however, the court did not end its analysis there. It held that a work-product privilege protects such analyses from a summons except where the IRS makes a sufficient showing of need to justify invading the integrity of the auditing process. 677 F.2d at 219. The Second Circuit reached this determination after balancing the Government's interest in enforcing the tax laws and collecting revenue against the public interest in ensuring fair and honest markets in securities transactions. The court determined that the factual data necessary to the IRS audit was already available to it, and that the tax accrual workpayers were no more than a "road map" that might save the IRS some time in finding the best arguments to use against the taxpayer for purposes of asserting a deficiency. It concluded that since the IRS was not attempting to prove fraud in the case, the IRS had no need to know the taxpayer's thoughts, and that giving the IRS the complete latitude it sought for the summons power would unnecessarily compromise the public interest in accurate financial reporting. *Id.* at 219-221.

The Fifth Circuit in the present case refused to apply the privilege recognized in *Arthur Young*, apparently on the ground that the privilege had been applied in *Arthur Young* only to outside accountants. App. 12a n.7. While it is true that the *Arthur Young* case involved a summons directed to the taxpayer's outside accountant, not to

the taxpayer itself, the holding in the case was premised on the importance of preserving "the integrity of the [independent] auditing process." 677 F.2d at 221. According to the Second Circuit's decision, this process depends upon "management feel[ing] free to cooperate with their auditors, and to disclose to them confidential information such as questionable positions taken on tax returns, and willingness to settle rather than litigate when these positions are challenged by the IRS." *Id.* at 219-220. Thus, the *Arthur Young* holding seeks to assure that in the preparation of the tax pool analysis and the subsequent discussion of its contents, the taxpayer and its accountant can be completely candid without fear of disclosure. Plainly, it is of no consequence to this holding whether it was the taxpayer or its accountant who actually prepared or retains the tax pool analysis. And just as plainly, the rejection of the privilege in the instant case conflicts with *Arthur Young*.

Indeed, the decision below may well completely eviscerate the Second Circuit's decision. For the IRS, frustrated by *Arthur Young* in its attempt to obtain the tax pool analysis from the independent accountant, could merely step across the street and demand it, or testimony concerning it, from the taxpayer. The IRS would thus have access to the same information sought to be protected in *Arthur Young* even though the identical policy considerations would apply. Moreover, the IRS itself has already made clear that this scenario is not simply a remote possibility. In May of 1981 it revised its audit guidelines to advise revenue agents to proceed as follows in order to gain access to tax pool analyses:

> [T]he examiner should first take all reasonable means to secure this information from the corporate officer before looking to the independent auditor to provide the information. [I Internal Revenue Manual (Audit) (CCH) § 4024.4(5) (1981).]

Accordingly, application of the decision below and the *Arthur Young* decision to essentially like circumstances will produce contradictory results. Authoritative guidance from this Court is needed to reconcile these contradictions.

C. Attorney-Client Privilege

The Fifth Circuit concluded that El Paso waived its attorney-client privilege as to all the documents and information in the tax pool analysis when it "discussed 'some of the information and many of the potential tax liability issues' in its tax pool analysis with the independent auditors who certify the corporation's books." App. 17a. The court expressly recognized, however, that this holding conflicted with *Arthur Young*, since under *Arthur Young* "the taxpayer's revelation of tax accrual workpapers to an accountant should be considered a communication in confidence." App. 19a (footnote omitted).

Furthermore, the Fifth Circuit's implicit ruling that a disclosure of information to an independent auditor pursuant to SEC requirements constitutes a waiver even though the information will not be made public is contrary to the *en banc* holding of the Eighth Circuit in *Diversified Industries, Inc.* v. *Meredith*, *supra*. The *Diversified Industries* court ruled that voluntary disclosure of documents to the SEC in a nonpublic SEC investigation constituted a waiver of the attorney-client privilege only as to the SEC. 572 F.2d at 611. Since in the present case the documents at issue were not ever disclosed to the SEC itself, but were only confidentially discussed with the Company's auditor in order to meet an SEC requirement,[9]

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[9] Moreover, as the court below recognized (App. 14a n.10), since its holding requires disclosure of the entire tax pool analysis, and any documents used to prepare the analysis, even though not all of the issues reflected in these documents were shown to have been discussed with the auditors, the holding conflicts with other Circuit Courts in this regard as well. *See United States* v. *Upjohn*, *supra*, 600 F.2d at 1227 n.12 (corporation's voluntary disclosure of

the Eighth Circuit's *Diversified Industries* holding would *a fortiori* preclude a finding of waiver.[10]

It is apparent, then, that the Fifth Circuit's decision in this case is in sharp conflict with numerous other Circuit Courts on the issues of relevance, work-product doctrine, and waiver of attorney-client privilege. The Court should review these issues in this case in order to resolve these conflicts and ensure uniform application of the law.

2. This Case Presents Important Questions of Law and Public Policy Which Should be Addressed by the Court.

El Paso's case raises important and recurring issues of law and public policy involving the tax laws, the securities laws, and the ability of legal and accounting professionals to advise their clients effectively. Specifically, the case presents three separate issues requiring that the Government's need to enforce its tax laws be balanced against another important, and conflicting, interest: first, against the public's need to ensure a full and free flow of financial information to the securities markets; second, against the public's interest in ensuring that the tax laws be *fairly* enforced, in a manner that involves no government overreaching; and, third, against the public's interest in ensuring that the tax laws are enforced in a way that does not jeopardize taxpayers' confidential relationships with their professional advisers. It is submitted

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privileged information to government agency constitutes waiver "only with respect to the facts actually disclosed"). *Accord, Weil* v. *Investment/Indicators Research & Management, supra*, 647 F.2d at 25; *United States* v. *Cote, supra*, 456 F.2d at 145 n.4.

[10] Other decisions conflicting with the *Diversified Industries* holding include the D.C. Circuit's decision in *Permian Corp.* v. *United States*, 665 F.2d 1214, 1219-22 (1981), and the Fourth Circuit's decision in *In re Weiss*, 596 F.2d 1185 (1979) (declining to apply limited waiver concept to grand jury proceedings following SEC investigation).

that the Court should grant the Petition in this case in order to review and provide guidance concerning these issues. We briefly summarize these issues below.

First, the IRS policy of issuing summonses for tax pool analyses has created a fundamental conflict between " 'the legitimate interest of society in enforcement of its laws and collection of the revenues,' *Couch* v. *United States*, 409 U.S. 322, 336 (1973), and the 'national public interest [in] insur[ing] the maintenance of fair and honest markets in [securities] transactions.' 15 U.S.C. § 78b." *Arthur Young*, 677 F.2d at 219. This conflict flows from the fact that, as pointed out above, the securities laws and regulations require public companies subject to the securities laws to file audited financial statements containing disclosure of material contingent tax liabilities. *See* 15 U.S.C. § 78*l*; 17 C.F.R. § 210.1-02(d) (1981).

The IRS policy places these public companies in a difficult dilemma. The company and its independent accountant *must* undertake a tax pool analysis if the company is to comply with SEC financial reporting requirements. Such an analysis necessitates consultation among the company employees responsible for the analysis and the independent accountant, as well as legal counsel. The more frank and candid these exchanges, the more reliable will be the assessment of contingent tax liability reported to the SEC and publicly disclosed in the company's financial statements. But at the same time, frankness and candor may well lead to vulnerability. This is because, under the ruling below, every expression of concern, every question raised, every good-faith doubt considered by the company must be disclosed and will inevitably invite and concentrate IRS scrutiny. Indeed, the company may well be met by a quotation from its own attorney or accountant if it should later challenge an IRS position or attempt a reasonable settlement of a dispute.

Moreover, the clear import of the ruling below is that the IRS is entitled not only to documents, notes, and other workpapers identifying potential "liabilities or tax problems," but also to the testimony of the attorneys and accountants who are responsible for such workpapers.[11] Testimonial evidence revealing subjective intent, opinions, and the like logically follows from the majority's reasoning because: (a) workpapers may make little or no sense without an explanation as to their meaning, and (b) if there were no privilege for documents, there would be none for testimony.

Nor will testimony be limited to the content of workpapers. Just as the summons in this case was broadly worded, so will the IRS be authorized to seek in each case the most extensive verbal "roadmap" through all of the company's transactions which could possibly affect tax liability, even if the witness is expressing pure speculation.

The company will thus be placed in a serious quandary. If its tax pool analysis is thorough, it subjects itself, its accountants, and its attorneys to unrestricted IRS inquiry and compromises its ability to defend, settle, or litigate any controversies that may arise. On the other hand, if it limits its tax pool analysis and tells its advisers as little as possible in order to shield them from inquiry, accuracy will necessarily be reduced and both the company and the public will be thereby disadvantaged. This quandary is not, as the Court of Appeals said, "wholly speculative." App. 26a-27a. On the contrary, it derives from common sense and experience and follows inexorably from the result reached below.

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[11] Thus, the summons at issue in this case ordered El Paso's principal tax counsel to appear and "give testimony" relating to the company's "tax liability or the collection of the tax liability * * *." App. 66a.

Both current IRS Commissioner Roscoe Egger and former Commissioner Mortimer Caplin have publicly recognized that this issue is of serious concern to the SEC, the accounting profession, businesses, and the public.[12] Thus, Commissioner Egger cites reports that IRS requests for tax pool analyses were "driving a wedge between CPA's and their clients" (IRS News Release, IR 81-49, *supra* note 12, at 3), cutting off the flow of tax accrual information to independent auditors, and causing concern to the SEC because of its interest in full financial disclosure. *Id.*[13] Caplin finds that "[t]he policy arguments for limiting the Service's access to accountants' tax accrual workpapers are persuasive," arguing that otherwise the quality of financial reporting will be harmed. 1 Va. Tax Rev., *supra* at 81-82. Finally, the Buchholz article cited above documents actual instances of the adverse effects of forced production of tax pool analyses on the quality of financial reporting. 40th N.Y.U. Institute on Federal Taxation, *supra* at 37-14, 37-16. *See also* Kurtz, *Discussion on "Questionable Positions,"* 32 Tax. Law. 13, 14 (1978) (remarks of former IRS Commissioner Jerome Kurtz before the May 20, 1978 meeting of the American Bar Association, Section on Taxation). We submit, therefore, that before the described balance is

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[12] IRS News Release, IR 81-49, Remarks by Roscoe L. Egger before the San Francisco Chapter of the California Institute of Certified Public Accountants and the Tax Section, San Francisco Bar Association, May 5, 1981; Caplin, *Government Access to Independent Accountants' Tax Accrual Workpapers*, *supra* 1 Va. Tax Rev. at 81-83 (1981).

[13] The IRS amended the Internal Revenue Manual on May 14, 1981 to establish a required system of administrative approval before tax pool analyses are sought from independent accountants. I Internal Revenue Manual (Audit) (CCH) ¶ 4024.4 (1981). The change appears merely to shift the burden of production from the accountant to the taxpayer. *See* Buchholz, *Tax Accrual File Controversy: Legal Problems Facing the Accountant*, 40th Annual N.Y.U. Institute on Federal Taxation 37-1, 37-14 (1981).

struck in favor of permitting the IRS unrestricted access to tax pool analyses, it is a matter of sufficient importance to warrant this Court's attention.

Second, before any such access is permitted, we believe that this Court should assess its fairness and its likely effect on our voluntary self-assessment tax system. It is clear that that system depends upon a perception by taxpayers of good faith and fairness on the part of the Government. It is also apparent that Government unfairness and overreaching created by excessive IRS demands for taxpayers' private thoughts and theories could erode the underpinnings of that voluntary system. *See* Caplin, *Government Access to Independent Accountants' Tax Accrual Workpapers*, *supra*, 1 Va. Tax. Rev. at 82 (to preserve self-assessment system, IRS must treat taxpayers in fair, evenhanded manner); Note, *A Balancing Approach to the Discoverability of Accountants' Tax Liability Workpapers Under Section 7602 of the Internal Revenue Code*, *supra*, 60 Wash. U.L.Q. at 207. IRS's authority in this regard should thus be reviewed by this Court and approved only after the necessary balancing has occurred.

Such a balancing should include, among other things, a recognition that the audit examination, negotiations, and any subsequent proceedings involve an adversary process. *See* Kurtz, *supra*, 32 Tax Law. at 25. The balancing should also assess the fairness of requiring the taxpayer in such a process to disclose its negotiating positions without placing a corresponding duty on the Government. Scrutiny of such a requirement should be particularly close in any case where the IRS has at its disposal all the facts it needs to make its determination of the amount of tax due.[14]

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[14] In the present case, the IRS identified concerns of speed and efficiency in the audit process—not unavailability of basic factual

Moreover, the balancing should take into account that requiring taxpayers to arm the IRS with arguments in order to challenge positions taken in their own returns may be a matter of such significance that no demand should be enforced on the basis of an ambiguous summons statute, but should await explicit congressional approval. This is particularly true here, where there is recent evidence that Congress would not sanction such summons authority. In § 323(a) of the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248 (to be codified at 26 U.S.C. § 6661), Congress has for the first time enacted a provision which *encourages* disclosure of positions for which the taxpayer does not have substantial authority.[15] This newly enacted statute goes nowhere near as far as the IRS is attempting to go by summoning tax pool analyses, and is an indication that such summonses would not meet with approval if the question were put to Congress.

In summary, serious and far-reaching questions of fairness are presented by the broad construction of the IRS summons power approved by the court below, and those questions should be considered by this Court before that construction is followed elsewhere.

Finally, the threat to the attorney-client privilege entailed in the ruling below is so significant that the ruling

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information—as its reason for seeking the tax pool analysis. TR., Vol. I, at 34. The IRS also stated that there was no evidence of fraud for which evidence of intent might be relevant. TR., Vol. I, at 72. In addition, this case is not a situation in which the taxpayer is postulated to be taking unreasonable positions on various issues in its tax return.

[15] This new section provides a penalty for substantial underpayment of tax, but forgives the penalty on any amount of understatement for which the taxpayer has adequately disclosed the relevant facts respecting the position taken on its return. The penalty is also forgiven if the taxpayer has substantial authority for its position.

should not receive further application without this Court's review. The purpose of the attorney-client privilege, as this Court has stated, is "to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice." *Upjohn*, *supra*, 449 U.S. at 389. The court below has now held that the privilege is lost as to all information on a particular subject when any part of that subject is discussed with a taxpayer's independent auditor. It has reached this conclusion in a case where the person to whom the information was communicated is bound by professional ethics and administrative rules of all 50 states not to disclose the information related to him.[16] AICPA Code of Professional Ethics, Rule 301 ("A member shall not disclose any confidential information obtained in the course of a professional engagement except with the consent of his client"). Moreover, the holding has occurred in a case where the client was obliged by other laws (here the securities laws) to make the disclosure.

The implications of such a holding, we submit, threaten the survival of the attorney-client privilege as designed by this Court in *Upjohn*. For the logic of the decision below, as pointed out by Judge Garwood in his dissenting opinion, is that any person who discusses any subject with his attorney forfeits all protection as to that discussion if he receives advice on the same subject from anyone else—even if the latter exchange was strictly confidential, and even if it was essential in order to comply with the law. Such a holding should not stand, much less without the review and approval of this Court.

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[16] The IRS recognizes in its Manual that the tax pool analysis consists in part of opinions and projections communicated *in confidence* to the independent accountant. I Internal Revenue Manual (Audit) (CCH) § 232.8(4) (1981).

CONCLUSION

Because of the conflict in the Circuit Courts on the issues of relevance and privilege in the enforcement of IRS summonses, and due to the importance of encouraging accurate financial reporting, promoting taxpayer faith in the fairness of the voluntary self-assessment system, and safeguarding the attorney-client privilege, it is submitted that the Court should review this case and provide the needed guidance to the lower courts on these recurring questions. We therefore respectfully urge the Court, for all the reasons stated, to grant a writ of certiorari and reverse the decision below.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

THE EL PASO COMPANY,
Petitioner,

v.

UNITED STATES OF AMERICA, *et al.*,
Respondents.

APPENDIX TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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APPENDIX A

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

No. 81-2484

UNITED STATES OF AMERICA and REVENUE AGENTS CLARENCE H. ISBEL and JOHN S. REID of the Internal Revenue Service,

Petitioners-Appellees,

v.

THE EL PASO COMPANY,

Respondent-Appellant.

Aug. 13, 1982

The United States District Court for the Southern District of Texas, Woodrow B. Seals, J., entered judgment enforcing Internal Revenue Service summonses issued to corporate taxpayer with regard to tax audit, and taxpayer appealed. The Court of Appeals, Jerre S. Williams, Circuit Judge, held that: (1) District Court's judgment extended only to taxpayer's tax pool analysis and supporting memoranda; (2) analysis was not shielded by attorney-client privilege; (3) documents in question were not protected work product materials; and (4) public policy reflected in security laws did not demand denial of enforcement of summons.

Affirmed.

Garwood, Circuit Judge, dissenting and filed opinion.

Appeal from the United States District Court
for the Southern District of Texas

Before GOLDBERG, WILLIAMS and GARWOOD, Circuit Judges.

JERRE S. WILLIAMS, Circuit Judge:

The United States and two agents of the Internal Revenue Service (IRS) petitioned the district court to enforce two summonses issued to the El Paso Company (El Paso) with regard to a tax audit. One summons sought El Paso's "tax-pool analysis"—a summary of El Paso's contingent liability for additional taxes should it ultimately be determined that El Paso owed more taxes than indicated on its return. After a hearing, the district court enforced the tax pool analysis summons and El Paso brought this appeal. We affirm.

I.

El Paso is the holding company for several large corporations, including 67 subsidiaries. The principal operations in the El Paso conglomerate are the El Paso Natural Gas Company, the El Paso Products Company, and the El Paso LNG Company. All are based in Texas. Because of the size and variety of El Paso's business, the calculation of El Paso's tax liability is an immense task. To prepare a return for a single year, El Paso's in-house staff expends over 10,000 hours.

The IRS, as it does with most giant corporations, annually audits El Paso and has been doing so since the 1940s. To perform the audit, the IRS assembles a team of revenue agents. Even with a team specifically assigned to El Paso, however, the IRS has time to review and inspect only a small sample of the documents that underlie El Paso's returns. The audit of El Paso that triggered the summons in this case was not conducted on suspicion of fraud; rather, it was a routine audit occasioned by the amount of taxes at stake.

Each audit of El Paso covers several years of tax returns. The relevant cycle in this case includes the

years, 1976, 1977, and 1978. Early in the audit of the 1976-1978 cycle, the IRS team coordinator delivered a document request to El Paso for "all analyses prepared by the El Paso Company regarding potential tax liabilities and tax problems" for the years covered by the cycle. Five days later, Jack McCarthy, the head of El Paso's tax department, returned the request form marked "refused".[1]

Shortly after receiving El Paso's refusal to respond to the potential tax-liabilities document request, the IRS issued a summons to McCarthy covering "any document, memorandum, letter, or work papers which identify potential tax liabilities or tax problems for the period begining January 1, 1976 and ending December 31, 1978, inclusive." McCarthy also declined to comply with the summons, stating his reasons in a letter written to the case manager of the El Paso audit.

On May 27, 1981, the IRS filed its petition to enforce the summons under 26 U.S.C. § 7604.[2] El Paso defended against enforcement on grounds of burdensomeness, relevance, attorney-client privilege, and work product doctrine. After a hearing at which both sides were permitted to call and cross-examine witnesses, the district court rejected El Paso's defenses and concluded that El Paso must comply with the summons.

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[1] The IRS had simultaneously submitted a request for a list of all internal-audit reports prepared by El Paso for the years covered by the cycle. McCarthy also refused this request. The IRS subsequently made the internal-audit request the subject of a summons. The district court enforced this summons and El Paso does not appeal from this aspect of the judgment.

[2] Section 7604(a) provides:

> If any person is summoned under the Internal Revenue laws to appear, testify, or to produce books, papers, records, or other data, the United States District Court for the district in which such person resides or is found shall have jurisdiction by appropriate process to compel such attendance, testimony, or production of books, papers, records, or other data.

El Paso appealed and sought a stay of the district court's judgment from this Court. Because of the importance and the novelty of the issues raised with respect to the IRS's summons powers, we granted the stay pending our resolution of the case.

II.

This appeal is centrally concerned with documents known to the accounting profession under various names —the noncurrent tax account, the tax accrual work papers, and the tax pool analysis. Because the nomenclature is not standardized, the IRS chose to request El Paso's version of these documents under a loose descriptive label—documents analyzing potential tax liabilities or tax problems. No matter what alias is used, however, the documents are of similar nature. It is useful to explain what these documents are before proceeding to determine whether the IRS may have access to them.

The income tax laws, as every citizen knows, are far from a model of clarity. Written to accommodate a multitude of competing policies and differing situations, the Internal Revenue Code is a sprawling tapestry of almost infinite complexity. Its details and intricate provisions have fostered a wealth of interpretations. To thread one's way through this maze, the business or wealthy taxpayer need the mind of a Talmudist and the patience of Job.

Even endowed with these qualities, however, no taxpayer completes a return with the certainty that the IRS will agree with the bottom line, or the many steps taken to get there. There is no tax oracle one may consult to learn how a return will fare under the scrutiny of the revenue agents and the courts. The Code, after all, is a finite system of rules designed to apply flexibility to an infinite variety of situations. There are many "gray areas" in the tax world, twilight zones in which one may only dimly perceive how properly to treat a given accretion to wealth or given expenditure of funds.

When a large corporation like El Paso completes its return, the number of decisions in the gray areas is enormous. To characterize a sale as ordinary income or capital gain, to depreciate equipment over ten years or twenty, to attribute a transaction to this year or to the next: these decisions recur over and over in a course of preparing a return and guarantee that a large corporation has many opportunities to choose in good faith an interpretation of the tax code that leans toward lessening its taxes. The return is filed with the understanding, however, that the IRS may challenge some of these questionable positions and, through settlement or litigation, the corporation may end up owing more taxes than it initially acknowledged.

Business reality compels corporations to recognize on their financial sheets that the return as filed is not the last word in determining the taxes owed. Public companies subject to the securities laws must file financial statements with the Securities and Exchange Commission (SEC), 15 U.S.C. § 78*l*. SEC regulations require that independent accountants verify these financial statements in accord with Generally Accepted Auditing Principles, 17 C.F.R. § 210.1-02(d). To demonstrate to the accountant that a balance sheet does not portray an overly-rosy view of a corporation's financial health, the balance sheet must provide for contingent future tax liabilities. In short, the corporation must set aside an account to cover additional taxes that it may become liable to pay above and beyond the amount indicated on the initial return.

To comply with the securities laws, therefore, companies such as El Paso *must* prepare in-house or have prepared by outside auditors an analysis of their contingent tax liabilities.[3] The analysis pinpoints the soft spots on the

[3] El Paso also informs us that the New York Stock Exchange requires that a corporation whose stock is traded on the Exchange have its books audited in accord with Generally Accepted Auditing

corporation's tax returns and indicates those areas in which the taxpayer has taken a position that may, upon challenge, negotiation, or litigation, require the payment of more taxes. The analysis is known in the trade as the tax pool analysis, the noncurrent tax account, or tax accrual work papers.

Several points are worth noting about the tax pool analysis. First, it is not prepared to assist in filling out a tax return. The tax pool analysis is undertaken only after the return is filed. Although the same corporate employees or outside auditors may prepare both the return and the tax pool analysis, there is no necessary connection between the two jobs.

Second, the tax pool analysis may be performed either in house or by outside accountants. El Paso happens to prepare its own tax pool analysis, but many firms retain outside accounts to accomplish that task. *See United States v. Arthur Young & Co.*, 677 F.2d 211 (2d Cir. 1982). It is not essential to consult an attorney to prepare the tax pool analysis.

Finally, the tax pool analysis is "[p]repared for financial reporting purposes alone. . . ." Caplin, *IRS Toughens Its Stance on Summoning Accountant's Tax Accrual Workpapers*, J. Tax 130 (Sept. 1980). While the analysis must forecast the cumulative results of IRS audit, settlement, and litigation, the tax pool analysis itself is not prepared to respond to a specific charge by the IRS or to any pending or impending lawsuit. The tax pool analysis is undertaken solely to insure that the corporation sets aside on its balance sheet a sufficient amount to cover contingent tax liability.

Principles. Moreover, banks that lend to public companies may also demand that a corporation maintain an account for contingent tax liabilities.

III.

Before we turn to the objections raised by El Paso to the enforcement of the "potential tax liabilities" summons, we must determine the scope of the judgment below. El Paso contends that the judgment requires production of much more than the tax pool analysis and backup memoranda and files. In El Paso's view, the district court's judgment encompasses all El Paso documents that treat "tax problems." This category, El Paso tells us, is so broad as to comprise all files in El Paso's tax department.

El Paso also protests that it relied on IRS representations at trial that the government sought only the tax pool analysis and backup files, and defended the case on that basis. To expand the judgment beyond the tax pool analysis and backup files, El Paso concludes, is unjust.

Finally, El Paso contends that there are no "backup files" to the tax pool analysis. The tax pool analysis consists of four to five accounting pages each year listing items the tax treatment of which might be vulnerable to challenge. A dollar amount is indicated for each item. El Paso denies that specific backup files exist.

We first review the genesis of the judgment's language. The subject matter of the original IRS summons was documents concerning "potential tax liabilities and tax problems." According to the IRS, it chose this language because it did not know what name El Paso bestowed on its tax-accrual workpapers file. The district court issued an order to El Paso to show cause why the summons should not be enforced. In answer, El Paso revealed its terminology, at least in part. An affidavit filed by El Paso referred to the "vast majority" of the documents sought by the summons at issue as "documents containing or comprising the 'tax pool analysis' or discussing items reflected in the company's financial statements as income or expense where the ultimate tax treatment was or is unclear." While written in the disjunctive, this refer-

ence actually points to but a single set of documents. The more expansive language in the latter portion of the statement is drawn from the IRS's own guidelines that define the term tax pool analysis.[4]

At the summons enforcement hearing, El Paso complained that it was unable to defend against enforcement because the summons lacked sufficient clarity to apprise it of the documents sought. The IRS responded that the El Paso affidavit, quoted above, adequately described what the government wanted. Since El Paso itself had used the term tax pool analysis, the IRS argued, El Paso could not deny that it knew what the IRS was after. The IRS conceded, however, that if the court found that the summons was too broad as written, the court could narrow it to the documents described in the El Paso affidavit.

The district court was understandably perplexed by the inability of the parties to agree on the subject matter of the summons. To give the IRS a chance to clarify what it sought, the court briefly recessed. In the recess, El Paso told the IRS that its reserve for contingent tax liability was called "the non-current tax account." The size of the non-current tax account was determined through the tax pool analysis.

The IRS then reduced to writing a description of the documents it sought:

1. Non-current tax account plus backup.
2. Documents identifying tax problems or potential tax problems created in or referred to the Tax Department or its superiors.

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[4] On June 12, 1980, the IRS adopted for the first time guidelines for the summoning of tax accrual workpapers. *Caplin*, *supra*; Internal Revenue Manual § 4024.3, *revised*, May 14, 1981. The manual defines tax pool analysis in part as "a memorandum discussing items reflected in the financial statements as income or expense where the ultimate tax treatment is unclear." This definition has been retained in the May 14, 1981 revision.

The judgment enforcing the summons substantially tracks this language.

We must interpret the judgment in the context in which its specific language was chosen. The IRS and El Paso wrangled over the scope of the summons. To give shape to its request, the IRS sought to borrow language from an El Paso affidavit. When this language also produced confusion, the IRS turned to yet other clarifying terms. This linguistic pas de deux yielded the language that the judgment now embodies.

The first sentence of the clarification of the summons, we believe, is tolerably clear. The "noncurrent tax account" refers to the four to five page list of the items believed to be vulnerable to challenge. This list is also known as the tax pool analysis. "Backup" refers to the memoranda on which the assessment of vulnerability is based. Despite El Paso's denial that back-up files exist, El Paso's witnesses testified that, for many if not all items in the tax pool analysis, supporting memoranda can be found in various "subject" files scattered in the Tax Department. The summons seeks these memoranda in addition to the four to five page list.

The second sentence of the clarification of the summons is considerably less lucid. The language "tax problems or potential tax liabilities" had stimulated El Paso's original concerns about the breadth of the summons. At trial, the IRS represented that this language could be faithfully recast in the words used in El Paso's affidavit. The IRS is bound by this representation. The affidavit, as we have seen, only borrows the IRS's own definition of tax pool analysis. This circle of definitions brings us back to square one. We are unable to give content to the second part of the IRS clarification in any fashion that avoids duplication of the first part.[5]

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[5] In fact, the second part of the clarification is theoretically narrower than the first because it is restricted to documents created in or referred to the Tax Department or the Department's superiors.

We conclude, therefore, that the judgment reaches only the tax pool analysis, as described herein, and the memoranda contained in various subject files that were used to prepare the tax pool analysis. On that understanding of the judgment, we proceed to the merits of this appeal.

IV.

The IRS exercised its summons power in this case under 26 U.S.C. § 7602. That section authorizes the IRS "[t]o examine any books, papers, records, or other data which may be relevant" to determining the correctness of the return. Under the Supreme Court's seminal decision in *United States v. Powell*, 379 U.S. 48, 85 S.Ct. 248, 13 L.Ed.2d 112 (1964), the IRS need not show probable cause to obtain judicial enforcement of the summons. Rather, the government need only make a preliminary showing that

> "The investigation will be conducted pursuant to a legitimate purpose, that the inquiry may be relevant to the purpose, that the information sought is not already within the Commissioner's possession, and that the administrative steps required by the Code have been followed. . . ."

379 U.S. at 57-58, 85 S.Ct. at 254-55; *United States v. Grayson County State Bank*, 656 F.2d 1070, 1073 (5th Cir. 1981), *cert. denied*, —— U.S. ——, 102 S.Ct. 1276, 71 L.Ed.2d 460 (1982).

As we observed in *United States v. Davis*, 636 F.2d 1028 (5th Cir. 1981),

> Once the government has satisfied this minimal requirement, the burden shifts to the summonee either to disprove one of the four elements of the government's prima facie showing or to demonstrate that judicial enforcement of the summons would otherwise constitute an abuse of the court's process.

636 F.2d at 1034.

El Paso argues that the tax pool analysis summons is not relevant to any legitimate IRS inquiry. In El Paso's view, the tax pool anlysis represents "a compilation of opinion and speculation on the adequacy of the provision for taxes shown on El Paso's financial statements." Containing no source documents with the details of actual transactions, the tax pool analysis is only a forecast of contingent tax liabilities prepared for the company's financial sheets. El Paso concedes that the IRS has a right to factual information upon which the return is based, but denies that the taxpayer's predictions about the outcome of an audit have any bearing on the correctness of the return as filed. El Paso relies heavily on *United States v. Coopers & Lybrand*, 550 F.2d 615 (10th Cir. 1977), in which the court denied the relevance of a tax pool anlysis to an IRS investigation.

We reject the view that the tax pool analysis fails the relevance test. An IRS summons is not judged by the relevance standards used in deciding whether to admit evidence in court. Rather, the well-established test is "whether the summons seeks information which 'might throw light upon the correctness of the taxpayer's return.'" *United States v. Wyatt*, 637 F.2d 293, 300 (5th Cir. 1981) (upholding the relevance of the so-called "eleven questions" designed to ferret out information on corporate payment of bribes). *See also United States v. Noall*, 587 F.2d 123, 125 (2d Cir. 1978) *cert. denied*, 441 U.S. 923, 99 S.Ct. 2031, 60 L.Ed.2d 396 (1979) (upholding the relevance of internal-audit work papers).

The IRS seeks here El Paso's assessment of the questionable positions it took on its return, an assessment prepared for financial reporting purposes. That the tax pool analysis is neither used in preparing a return nor is a "source document" of an actual transaction does not bar a finding of relevance.[6] A tax return is much more than

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[6] *See United States v. Euge*, 444 U.S. 707, 100 S.Ct. 874, 63 L.Ed.2d 141 (1980) (upholding the IRS's power to compel the

a tabulation of transactions neatly fitted into an existing structure of tax concepts. The return largely represents an interpretation of transactions in the light most favorable to the taxpayer. The task of the Service in determining whether the return is correct is not only to verify the existence of the actual transactions cumulatively recorded in the return. The IRS must also determine whether the taxpayer has stretched a tax concept to cover a transaction to which the concept does not apply. Documents that focus and concentrate the Service's energy on questionable positions in the return, therefore, are highly relevant. It is, in fact, hard to imagine a document more likely to shed light on the correctness of those aspects of a return that harbor doubts than the tax pool analysis.

Our holding accords with the similar conclusion on the relevance of tax-accrual work papers recently reached by the Second Circuit in *United States v. Arthur Young & Co.*, 677 F.2d 211 (2d Cir. 1982). Facing an argument that tax-accrual work papers prepared by an independent auditor are not relevant, the court succinctly stated "[d]ifferent tax positions lead to different amounts of liability. It is difficult to say that the assessment by the independent auditor of the correctness of positions taken by the taxpayer in his return would not throw 'light upon' the correctness of his return." At 219.[7] We agree with this view and hold that the tax pool analysis is relevant to an IRS audit.

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execution of a handwriting exemplar); *United States v. Noall*, 587 F.2d at 126 (IRS may summon internal audit reports prepared after the return was filed).

[7] Although the *Arthur Young* court found tax-accrual workpapers relevant, the court declined to enforce production of them. The court held that the workpapers were shielded by an accountant work product doctrine that was necessary to fulfill the purposes of the securities laws in demanding accurate financial statements. 677 F.2d at 219-21. We need not reach the issue of an accountant work product doctrine because the IRS here summoned the tax pool analysis from the taxpayer itself, not from an independent accountant.

V.

We now turn to El Paso's contention that the tax pool analysis is shielded by the attorney-client privilege. El Paso carries the burden of establishing this defense to the enforcement of the summons. *United States v. Powell*, 379 U.S. at 58, 85 S.Ct. at 255; *United States v. Davis*, 636 F.2d at 1034.

In *Upjohn Co. v. United States*, 449 U.S. 383, 101 S.Ct. 677, 66 L.Ed.2d 584 (1981), the Supreme Court delineated the purpose of the attorney-client privilege.[8]

> The attorney-client privilege is the oldest of the privileges for confidential communications known to the common law. 8 Wigmore, Evidence § 2290 (McNaughton Rev. 1961). Its purpose is to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice. The privilege recognizes that sound legal advice or advocacy serves public ends and that such advice or advocacy depends upon the lawyer being fully informed by the client. As we stated last term in *Trammel v. United States*, 445 U.S. 40, 51, 100 S.Ct. 906, 913, 63 L.Ed.2d 186 (1980), "the attorney-client privilege rests on the need for the advocating counselor to know all that relates to the client's reasons for seeking representation if the professional

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[8] In *Upjohn* the IRS summoned the files of a corporate taxpayer's general counsel on the counsel's investigation of illegal foreign payments made by the corporation. The Court held that the attorney-client privilege protected the files whether or not the client communications therein were made by the corporation's "control group." Because the purpose of the attorney-client privilege is to promote the flow of information to the attorney to enable him to give informed legal advice, communications from lower echelon employees were within the privilege as long as the communications were made to the attorney to assist him in giving legal advice to the client corporation. 101 S.Ct. at 682-86.

> mission is to be carried out." And in *Fisher v. United States*, 425 U.S. 391, 403, 96 S.Ct. 1569, 1577, 48 L.Ed.2d 39 (1976), we recognized the purpose of the privilege to be "to encourage clients to make full disclosures to their attorneys."

Id. 101 S.Ct. at 682.

The scope of the attorney-client privilege is shaped by its purposes. *United States v. Pipkins*, 528 F.2d 559, 563 (5th Cir. 1976), *cert. denied*, 426 U.S. 952, 96 S.Ct. 3177, 49 L.Ed.2d 1191 (1976). While the elements of the privilege have been comprehensively restated elsewhere,[9] it is sufficient here to note that "[w]hat is vital to the privilege is that the communication be made *in confidence* for the purpose of obtaining *legal* advice *from the lawyer*." *United States v. Kovel*, 296 F.2d 918, 922 (2d Cir. 1961) (emphasis in original). *See United States v. Miller*, 660 F.2d 563 (5th Cir. 1981); *Colton v. United States*, 306 F.2d 633, 637 (2d Cir. 1962), *cert. denied*, 371 U.S. 951, 83 S.Ct. 505, 9 L.Ed.2d 499 (1963). Moreover, "disclosure of any significant portion of a confidential communication waives the privilege as to the whole." *United States v. Davis*, 636 at 1043 n.18.[10] Finally, we have

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[9] *See* 8 J. Wigmore Evidence § 292 at 554 (J. McNaughton rev. 1961):

> (1) Where legal advice of any kind is sought; (2) from a professional legal advisor in his capacity as such; (3) the communications relating to that purpose; (4) made in confidence; (5) by the client; (6) are at his instance permanently protected; (7) from disclosure by himself or by the legal advisor; (8) except the protection be waived.

See generally Petersen, Attorney Client Privilege and Internal Revenue Service Investigations, 54 Minn.L.Rev. 67 (1969).

[10] The Sixth Circuit might take a different view of disclosure, *see United States v. Upjohn Co.*, 600 F.2d 1223, 1227 n.12 (6th Cir. 1979) ("the corporation's voluntary disclosure to the SEC amounts to a waiver of the privilege only with respect to the facts actually disclosed"), *rev'd*, 449 U.S. 383, 101 S.Ct. 677, 66 L.Ed.2d 584 (1981). The Supreme Court in *Upjohn* noted the Sixth Circuit's

made clear that the attorney-client privilege may not be tossed as a blanket over an undifferentiated group of documents. *United States v. Davis*, 636 F.2d at 1044 n. 20; *United States v. Roundtree*, 420 F.2d 845, 852 (5th Cir. 1969). The privilege must be specifically asserted with respect to particular documents.

The IRS argues that El Paso has failed to prove any of the elements of the attorney-client privilege. In its broadest theory, the IRS urges that preparing the tax pool analysis is not legal work and that El Paso's attorneys in performing it are not giving legal advice. In the IRS's view the tax pool analysis is a business document, drawn up solely to bring the company's financial statements in line with generally accepted auditing principles. Because the tax pool analysis simply supports a record of the corporation's finances, the IRS sees it as business work rather than legal work.

The line between accounting work and legal work in the giving of tax advice is extremely difficult to draw. *See* Kenderdine, The Internal Revenue Service Summons to Produce Documents: Powers, Procedures & Taxpayer Defenses, 64 Minn.L.Rev. 73, 100-01 (1979). We have held that the preparation of tax returns is generally not legal advice within the scope of the privilege. *United States v. Davis*, 636 F.2d at 1043. *See Canaday v. United States*, 354 F.2d 849 (8th Cir. 1966); *Olender v. United*

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treatment of the waiver issue but did not discuss or decide it, *see* 101 S.Ct. at 682.

The revelations to the SEC made in *Upjohn* were facts concerning foreign payments. The attorney-client privilege does not protect against discovery of underlying facts from their source merely because those facts have been communicated to an attorney. 101 S.Ct. at 685-86. The public disclosure of those facts, moreover, does not destroy the privelege with respect to attorney-client communications about those facts. Thus, it is not clear that the Sixth Circuit was concerned in *Upjohn* with a potential divulgence of a confidential communication.

States, 210 F.2d 795, 805-06 (9th Cir. 1954), *cert. denied*, 352 U.S. 982, 77 S.Ct. 382, 1 L.Ed.2d 365 (1957). *Davis* withheld the privilege from communications made to an attorney to prepare a tax return because such work is primarily an accounting service. The tax pool analysis may also be considered an accounting service since it is often performed by accountants, *see* Diss & Hanson, Tax Contingency Audit Work Papers: Current Developments, Observations, and Proposals, Tax Advisor 104 (Feb. 1981). Nevertheless, we would be reluctant to hold that a lawyer's analysis of the soft spots in a tax return and his judgments on the outcome of litigation on it are not legal advice. We need not decide this issue, however, because we believe that El Paso's attempt to claim the privilege fails on other grounds.

To retain the attorney-client privilege, the confidentiality surrounding the communications made in that relationship must be preserved. The purpose of the privilege is to foster full client disclosure to the lawyer; the privilege exists to assure the client that his private disclosures will not become common knowledge. The need to cloak these communincations with secrecy, however, ends when the secrets pass through the client's lips to others. Thus, a breach of confidentiality forfeits the client's right to claim the privilege. *Permian Corp. v. United States*, 665 F.2d 1214, 1219 (D.C. Cir. 1981) (when confidential communications are voluntarily disclosed to one person, the privilege is waived as to all others); *United States v. Miller*, *supra* (previous delivery of accounting books to the IRS robbed them of the confidentiality needed to maintain the attorney-client privilege); McCormick on Evidence § 93 (2d ed. 1972). As Justice Holmes wrote when a member of the Massachusetts Supreme Court,

> [T]he privacy for the sake of which the privilege was created was gone by the appellant's own consent, and the privilege does not remain in such circum-

> stances for the mere sake of giving the client an additional weapon to use or not at his choice.

Green v. Crapo, 181 Mass. 55, 62 N.E. 956, 959 (1902).

The district court found in this case that El Paso discussed "some of the information and many of the potential tax liability issues" in its tax pool analysis with the independent auditors who certify the corporation's books. This finding is not clearly erroneous.[11] *Pullman-Standard v. Swint*, —— U.S. ——, 102 S.Ct. 1781, 72 L.Ed.2d 66 (1982). The evidence showed that in the course of the audit, the accountants determine whether the company has set aside an adequate reserve for contingent taxes. This task carries the auditors into the tax pool analysis and into at least some of the supporting memoranda. Confidentiality as to these documents is neither expected nor preserved, for they are created with

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[11] El Paso urges us to give less deference to the district court's findings than Fed.R.Civ.P. 52(a) indicates because the findings were prepared by the IRS and adopted verbatim by the court. Trial courts in this Circuit frequently adopt findings of fact prepared by counsel. This circumstance alone does not strip the findings of the protection of the clearly erroneous rule. When "[t]he record reflects that the trial court fully comprehended the factual and legal issues and adequately performed the 'decision reaching process'" the clearly erroneous rule applies with full force to findings of fact prepared by the parties and adopted by the court. *Odeco, Inc. v. Avondale Shipyards, Inc.*, 663 F.2d 650, 652-53 (5th Cir. 1981), *quoting, Kaspar Wireworks, Inc. v. Leco Eng. & Mach. Inc.*, 575 F.2d 530, 543 (5th Cir. 1978).

We have reviewed the record in this case and conclude that the trial court more than adequately performed its role as decision maker. The court played an active part throughout the trial in sharpening the issues and bringing out the evidence. At the close of the case, the court made oral findings of fact and conclusions of law, and directed the IRS to prepare findings and conclusions in accord with them. Moreover, the record reflects that the trial judge's findings rest in part on his assessment of the relative credibility of the witnesses. We, therefore, give the district court's findings the deference that Rule 52(a) mandates.

the knowledge that independent accountants may need access to them to complete the audit. *See United States v. Pipkins*, 528 F.2d at 563.

El Paso generates the tax pool analysis to portray its financial condition accurately. As the securities laws require, independent accountants then verify the financial statements by probing the corporation's reasons for allocating a given amount of its noncurrent tax account.[12] In El Paso's case, the tax pool analysis is revealed to the independent accountants as part of their audit. Our Circuit does not recognize an accountant-client communications privilege, *United States v. Davis*, 636 F.2d at 1043; *Falsone v. United States*, 205 F.2d 734 (5th Cir. 1953), *cert. denied*, 346 U.S. 864, 74 S.Ct. 103, 98 L.Ed. 375 (1953), and, as the Supreme Court has acknowledged, neither does any other federal court. *Couch v. United States*, 409 U.S. 822, 835, 93 S.Ct. 611, 619, 34 L.Ed.2d 548 (1973) (". . . we note that no confidential accountant client privilege exists under federal law, and no state created privilege has been recognized in federal cases. . . ."); 2 J. Weinstein & M. Burger, Weinstein's Evidence

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[12] The *Arthur Young* court gave the following description of the auditing process:

> [G]enerally accepted auditing standards require an auditor to determine whether his client has put aside enough reserves to cover the contingency that upon audit it will owe the government more taxes than originally remitted. To make this assessment, the auditor must determine not only how the taxpayer treated his income and expenses in his tax return; he must also decide whether that treatment comports favorably with the Internal Revenue Code, the regulations, and the case law. In areas where the law is unclear, he must predict the chances that the taxpayer's position will be upheld by the courts—a judgment based on his knowledge of the law and his opinion of where the law is headed. The auditor must also take into account the likelihood that the client will settle the dispute—a judgment based on the auditor's confidential and intimate knowledge of the client.

677 F.2d at 217.

¶ 503(a)(3)[01] (1981). Under these circumstances, El Paso's disclosure of the tax pool analysis to the auditors destroys confidentiality with respect to it. With the destruction of confidentiality goes as well the right to claim the attorney-client privilege.

We recognize that the Second Circuit has denied enforcement of IRS summons to the taxpayer's accountant seeking tax accrual workpapers that the accountant has prepared. *United States v. Arthur Young & Co., supra.* The logic of *Arthur Young* implies that the taxpayer's revelation of tax accrual workpapers to an accountant should be considered a communication in confidence.[13] *Arthur Young* does not persuade us, however, that El Paso's disclosure of its tax pool analysis to its independent accountants is consistent with the confidentiality required to assert the attorney-client privilege. To extend *Arthur Young* to this case would, in effect, create an accountant-client communications privilege. No such privilege exists under federal law, however, as we noted above.

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[13] The *Arthur Young* court reasoned that if the IRS could reach tax accrual workpapers prepared by accountants, taxpayers might conceal their tax vulnerabilities from the accountants. The concealment, in turn, would impair the accuracy of financial statements and the ability of investors to rely on them. In the Second Circuit's view, this result would run counter to the policy of the securities laws to guard investors against flawed financial information. Accordingly, the Second Circuit fashioned an accountant's work-product rule for tax accrual workpapers, 677 F.2d at 221.

To the extent that the Second Circuit wished to encourage companies to reveal freely their tax vulnerabilities to independent accountants, the *Arthur Young* rule implicitly strives to shelter the confidentiality of the taxpayer's communications to the accountant about the noncurrent tax account. *See Arthur Young*, 677 F.2d at 223 n.5 (dissenting opinion observing that the *Arthur Young* holding is grounded on policies more germane to a client-communications confidentiality rule than an accountant's work-product rule). Thus, if we were to adopt the reasoning of *Arthur Young*, a question would arise whether the El Paso's communications to its accountants were confidential, and, therefore, not in breach of the confidentiality necessary to assert the attorney-client privilege.

In the absence of a contrary rule established by law, we cannot view El Paso's discussions with its auditors as confidential. The attorney-client privilege is, therefore, waived.

We believe that El Paso may not withdraw behind the shield of the attorney-client privilege for an additional reason. El Paso failed to particularize its assertion of the privilege and prove its case with respect to any specific document. El Paso made only a blanket assertion of the privilege as to all documents in, or backing up, its tax pool analysis. Such a showing is simply inadequate.

In *United States v. Davis*, we reiterated the unacceptability of blanket assertions of the attorney-client privilege. 636 F.2d at 1044 n.20. Such assertions disable the court and the adversary party from testing the merits of the claim of privilege. In *Davis* we relaxed the rule because of confusion about when the attorney-client privilege should be raised in a tax summons enforcement proceeding. We cautioned, however, that "future litigants who make only blanket assertions of privilege at enforcement proceedings should not expect such grace." *Id.* El Paso had fair notice of the obligation to make its privilege claim precise.[14] We cannot excuse its failure to do so.

The reasons for refusing to tolerate blanket assertions of the privilege apply fully to this case. El Paso's tax department employs eighty accountants and ten attorneys. The tax department as a whole has responsibility for preparing the various memoranda that underpin the tax pool analysis. Both the head of the tax department and the general counsel testified at the enforcement hearing, but neither witness had reviewed the backup memoranda prior to testifying. As a result, neither was able to state how many or which memoranda were prepared by attorneys rather than by accountants.

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[14] *United States v. Davis* was decided on February 12, 1981; the government filed its enforcement petition to this case on May 27, 1981.

El Paso's failure to prove which documents were prepared by attorneys considerably undermines its claim to the attorney-client privilege. Because the privilege does not attach to tax work prepared by accountants unless the accountant is translating complex tax terms into a form intelligible to a lawyer at the lawyer's behest, *United States v. Kovel*, 296 F.2d at 922, the memoranda prepared by accountants do not qualify for the privilege. We cannot say that any single memorandum in the El Paso's tax department is stamped with an attorney's seal. A general claim that the tax department funnels tax work through its attorneys will not do, and El Paso's proof amounted to little more.

We hold, therefore, that El Paso has breached the confidentiality needed to shield its attorney-client communications, and in any event, has failed to meet its burden to assert the privilege specifically. The attorney-client privilege does not protect El Paso against disclosing the documents that the IRS seeks.

VI.

El Paso next contends that the work product doctrine immunizes the tax pool analysis from production.[15] It

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[15] The work product doctrine is embodied in Federal Rule of Civil Procedure 26(b)(3) which provides:

> "*Trial Preparation: Materials* Subject to the provisions of subdivision (b)(4) of this rule, a party may obtain discovery of documents and tangible things otherwise discoverable under subdivision (b)(1) of this rule and prepared in anticipation of litigation or for trial by or for another party or by or for that other party's representative (including his attorney, consultant, surety, indemnitor, insuror, or agent). Only upon a showing that the parties seeking discovery have substantial need of the materials in the preparation of his case and that he is unable without undue hardship to obtain the substantial equivalent of the materials by other means in ordering discovery of such materials when the required showing has been made, the court shall protect against disclosure of the mental impressions, conclusions, opinions, or legal theories of an attorney or other representative of a party concerning the litigation.

is settled, of course, that a work product defense may be asserted against enforcement of an IRS summons. *Upjohn Co. v. United States*, 101 S.Ct. at 686.

The work product doctrine traces its lineage to the Supreme Court's decision in *Hickman v. Taylor*, 829 U.S. 495, 67 S.Ct. 385, 91 L.Ed 451 (1947). In *Hickman*, the plaintiff's attorney sought to discover notes that the defendant's attorney had taken in interviews of prospective witnesses in preparation for trial. The Court rejected this discovery attempt, which was made without any special showing of need. The Court held that the work of preparing for trial demands insulation from opposing counsel's inquiries on a lawyer's research, analysis, legal theories, and mental impressions. To adopt a more lenient approach to discovery of an attorney's work product would deter lawyers from committing to paper their work in preparation for trial and would thus diminish the quality of representation. Moreover, the invasion of a lawyer's private thoughts would demoralize the profession. 329 U.S. at 510-512, 67 S.Ct. at 393-94. "An attorney's thoughts, hithertofore inviolate, would not be his own." *Id.* at 511, 67 S.Ct. at 393-94.

The accent in *Hickman* was on a lawyer's need for a sphere of privacy in preparing a lawsuit. "At its core, the work product doctrine shelters the mental processes of the attorney, providing a privileged area within which he can analyze and prepare his client's case." *United States v. Nobles*, 422 U.S. 225, 238, 95 S.Ct. 2160, 2170, 45 L.Ed.2d 141 (1975) (*applying* the work product doctrine to criminal trials).

The work product doctrine is not an umbrella that shades all materials prepared by a lawyer, however. The work product doctrine focuses only on materials assembled and brought into being in anticipation of litigation. Excluded from work product materials, as the advisory committee notes to Rule 26(b)(3) make clear, are

"[m]aterials assembled in the ordinary course of business, or pursuant to public requirements unrelated to litigation. . . ." 48 F.R.D. at 501.

Even assuming that El Paso's tax pool analysis otherwise qualifies for work product protection, we hold the doctrine unavailable here because the tax pool analysis is not prepared "in anticipation of litigation." But in doing so we concede that determining whether a document is prepared in anticipation of litigation is a slippery task. *See In Re Grand Jury Investigation*, 599 F.2d 1224, 1229 (3d Cir. 1979); 8 C. Wright & A. Miller, Federal Prac. & Pro. § 2024 at 198 (1970). In *United States v. Davis* we phrased the test in the following terms. "[L]itigation need not be imminent . . . as long as the primary motivating purpose behind the creation of the document was to aid in possible future litigation." 636 F.2d at 1040. *Davis* held that an attorney's work in preparing a tax return did not fall under the work product doctrine because the work was not primarily motivated to assist in future litigation over the return. We reach a similar conclusion with respect to El Paso's tax pool analysis.

El Paso establishes its non-current tax account to bring its financial books into conformity with generally accepted auditing principles. The desire to please the accountants, in turn, is compelled by the securities laws. The primary motivating force behind the tax pool analysis, therefore, is not to ready El Paso for litigation over its tax returns. Rather, the primary motivation is to anticipate, for financial reporting purposes, what the impact of litigation might be on the company's tax liability. El Paso thus creates the tax pool analysis with an eye on its business needs, not on its legal ones.

We recognize that the tax pool analysis involves weighing legal arguments, predicting the stance of the IRS, and forecasting the ultimate likelihood of sustaining El Paso's position in court. Nevertheless, this analysis (as-

suming it is legal rather than accounting work) is only a means to a business end. The legal analysis is not an end in itself: the memoranda underlying the tax pool analysis do not map out El Paso's actual litigating strategy, should litigation occur. In fact, no single item in the tax pool analysis is specifically under scrutiny by the IRS when the memoranda are drafted. *Cf. Kent Corp. v. NLRB*, 530 F.2d 612, 123 (5th Cir. 1976), *cert. denied*, 429 U.S. 920, 97 S.Ct. 316, 50 L.Ed.2d 287 (1976) (investigation reports of the NLRB prepared after a charge has been filed are the NLRB attorney's work product because the charge contemplates litigation). Business imperatives, not the press of litigation, call these documents into being.

Moreover, El Paso's tax litigation is handled by outside counsel. *Cf. United States v. Gates*, 35 F.R.D. 524 (D. Colo.1964) (IRS documentary files on the taxpayer were not work product when referred to Justice Department attorneys who were prosecuting a tax suit against the taxpayer). Although an attorney from El Paso's tax department serves as co-counsel, outside counsel takes the lead in directing the conduct of El Paso's tax suits. There is no evidence in the record that the tax pool analysis or underlying memonanda are referred to outside counsel or used by El Paso's attorneys to prepare for trial or negotiations.

In tax refund suits against the United States, documents generated by the IRS in connection with its defense have been denied work product protection even though much more closely tied to litigation then El Paso's tax pool analysis. *Abel Investment Co. v. United States*, 53 F.R.D. 485 (D.Neb.1971); *Peterson v. United States*, 52 F.R.D. 317 (S.D.Ill.1971); *United States v. San Antonio Portland Cement Co.*, 33 F.R.D. 513 (W.D.Tex. 1963). In *Abel Investment*, the court denied the work product privilege to documents prepared by the IRS in response to a tax refund claim made by the taxpayer. The

documents impartially evaluated the strengths and weaknesses of the IRS's and the taxpayer's positions. The court held that the documents were not prepared in anticipation of litigation.

In support of its conclusion, the *Abel Investment* court observed that the reports were prepared routinely before any lawsuit began and were not developed by the attorney who would try the case, should litigation ensure. Moreover, "[t]he documents in all probability do not fix the government's theory of the case to be used at trial, because trial counsel should and undoubtedly would set the defense from all available facts and theories whether or not conceived or expressed by personnel at the various stages of the settlement process. . . ." 53 F.R.D. at 49. El Paso's tax pool analysis is even more distant from actual litigation than the IRS documents in *Abel Investment*. The factors mentioned in *Abel Investment* also point to a denial of work product protection here.

In sum, we believe that the tax pool analysis does not contemplate litigation in the sense required to bring it within the work product doctrine. The tax pool analysis concocts theories about the results of possible litigation; such analyses are not designed to prepare a specific case for trial or negotiation. Their sole function, from all that appears in the record, is to back up a figure on a financial balance sheet. Written ultimately to comply with SEC regulations, the tax pool analysis carries much more the aura of daily business than it does of courtroom combat. We hold, therefore, that the tax pool analysis and backup memoranda are not protected work product materials.

VII.

El Paso contends that we should refuse to enforce the tax pool analysis summons, even though it seeks otherwise relevant and nonprivileged documents, on grounds of public policy. El Paso urges us to constrict the sweep of

the IRS summons power because of the policy of the securities laws. To permit routine summoning of tax pool analyses from companies will have a chilling effect on the company's willingness to prepare such analyses searchingly and critically. Moreover, companies will conceal tax pool analyses from their auditors and thereby thwart the accountant's attempts to measure the adequacy of the contingent tax account. These consequences obstruct the full and frank disclosure of financial information that the securities laws envision. The public policy of protecting investors, therefore, demands that we deny the IRS access to a company's tax pool analysis.

We are not swayed by the argument that the public policy of the securities laws implicitly overrides the clear grant of summons power to the IRS. While the IRS does not enjoy untrammeled authority to direct the production of documents, *see Upjohn Co., supra,* (attorney-client privilege and work product doctrine are defenses to the enforcement of the summons in proper cases); *United States v. LaSalle National Bank,* 437 U.S. 298, 98 S.Ct. 2357, 57 L.Ed.2d 221 (1978) (good faith requirements); *United States v. Powell, supra,* Congress has endowed the IRS with broad authority to conduct tax investigations. The Supreme Court has "consistently construed congressional intent to require that if the summons authority claimed is necessary for the effective performance of congressionally imposed responsibilities to enforce the tax code, that authority should be upheld absent express statutory prohibition or substantial countervailing policies." *United States v. Euge,* 100 S.Ct. at 378; *United States v. Bisceglia,* 420 U.S. 141, 95 S.Ct. 915, 43 L.Ed.2d 88 (1975). We are unwilling to make inroads in the plainly-announced congressional policy to allow the IRS broad access to relevant, nonprivileged documents on the basis of El Paso's claim of a conflict with the policies underlying the securities laws.

The main premise of El Paso's argument is that the accuracy of financial reports will suffer if companies must divulge their tax pool analyses to the IRS. We find this

premise wholly speculative. El Paso paints a picture of corporations evading their responsibilities under the securities laws to prepare their financial books properly and to lay open their books and records to independent auditors. We do not join El Paso in assuming that corporations will dishonor their legal obligations by discontinuing the preparation of tax pool analyses. El Paso fails to recognize that "[i]f the corporation blocks the efforts of the accountants to ascertain . e true state of the company's contingent tax liabilities, the accountant would be obligated to decline to certify the financial statements." *United States v. Arthur Young*, 677 F.2d at 224, (dissenting opinion). The powers of the SEC suffice to ensure that companies will comply with law.[16]

We note as well that Congress granted the IRS "broad latitude to adopt enforcement techniques helpful in the performance of . . . tax collection and assessment. . . ." *United States v. Euge*, 100 S.Ct. at 880 n.9. This latitude enables the IRS, without judicial intervention, to temper the perceived ill-effects of summoning tax pool analyses. The IRS has recognized resistance to the production of

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[16] El Paso relies on the Supreme Court's refusal in *Upjohn* to narrow the attorney-client privilege simply because, as the government argued, corporations facing the risk of criminal liability have an adequate incentive to investigate wrongdoing even without the attorney-client privilege. The Court stated that the government's argument "ignores the fact that the depth and quality of any investigations to insure compliance with the law would suffer, even if they were undertaken. 101 S.Ct. at 684 n.2.

The Supreme Court used this argument to sustain the attorney-client privilege, a traditional and well-established feature of the legal landscape. That the centuries-old attorney-client privilege should not be toppled does not imply, however, that we should raise a new barrier, on shaky grounds, to IRS investigations. We find completely valid a distinction between the attorney-client privilege and the confidentiality of a tax pool analysis that recognizes that while consultation with an attorney is a private and voluntary act, the preparation of a tax pool analysis is ultimately compelled by the SEC. *See Arthur Young*, 677 F.2d at 224 (dissenting opinion).

tax-pool analyses and responded by tightening its internal requirements for the issuance of such summonses. *See* Internal Revenue Manual § 4024.4 (Guidelines for Requesting Audit or Tax Accrual Workpapers) (May 14, 1981). These guidelines have no retroactive effect on the IRS' power to summon the tax pool analysis in this case. They do, however, evidence administrative sensitivity to the concerns evoked by routinely summoning a company's tax pool analysis. This demonstration of administrative flexibility reenforces our decision not to trim the IRS' authority irrevocably.

By upholding the IRS' authority to reach the tax pool analysis, we do not unleash an inquisition. The tax pool analysis may be useful to the IRS as a "roadmap" through a company's tax return; it is not, however, an admission of guilt. The actual tax liability of El Paso is hammered out in negotiations and ultimately is subject to resolution in the courts. We therefore decline to hamper the efficiency that access to the tax pool analysis can bring to an IRS audit.

In the absence of a more profound clash between congressional policies, we cannot cut back on the summons power that Congress has given to the Service. We do not feel free to reweave the fabric of national legislation in accord with our notions of how various statutory schemes mesh. Such policy choices belong to the Congress. Accordingly, we find no public policy barrier to the enforcement of this summons.

CONCLUSION

Our tax collection system depends primarily on the voluntary compliance of taxpayers acting in good faith. Congress has chosen to enforce this system of self-assessment through an agency vested with broad investigatory powers. The enforcement of the revenue laws contemplates that the IRS may verify the basis of a re-

turn by a thorough audit of a taxpayer's record. Certainly, IRS access to a document, prepared for business reasons, that guides and channels the Service's energy and limited resources to those areas of the return deserving of special scrutiny fits within the congressional scheme of tax enforcement. Because we find the summons here to be authorized by Congress and not otherwise prohibited, we enforce the tax pool analysis summons.

We restate our holdings. First, we interpret the judgment to extend only to El Paso's tax pool analysis and supporting memoranda in various subject files. Second, we do not find El Paso's tax pool analysis shielded by the attorney-client privilege. Third, the documents in question are not protected work product materials. Fourth, we find a lack of public policy in the securities laws demanding that we deny enforcement. The stay of the district court's judgment is lifted, and the judgment is

AFFIRMED.

GARWOOD, Circuit Judge, dissenting.

I respectfully dissent.

The Internal Revenue Service ("IRS" or "Service") did not issue the summonses for El Paso's tax pool analysis to investigate fraud or negligence, nor to determine or discover any information respecting the actual receipts, disbursements or transactions engaged in by El Paso, the accuracy and completeness of its records, or any other *factual* information respecting El Paso's tax liability or the correctness of its return.[1] On the contrary, it is evident that the sole purpose of the summonses was to discover the *post-return* "private thoughts and theories of

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[1] I agree with the majority's analysis of the scope of the district court's enforcement order.

the taxpayer"[2] and "the thinking of [its] accounting analysts and policy makers about tax decisions."[3] Further, it is apparent that the IRS does not seek these theories and opinions of the taxpayer concerning its prior taxes because they may be relevant to the *actual* correctness of El Paso's returns or the *actual* amount of tax owed. The Service asserts no such potential relevance here. Rather, as the majority candidly recognizes, the taxpayer's theories and opinions are sought merely because they may "focus and concentrate the Service's energy," "may be useful to the IRS as a 'road map' through a company's tax return," and will enhance "the efficiency" of the "IRS audit." Accordingly, here the bottom line is *not* figures or facts or even opinions; it is, rather, the *convenience of the Service*. That will not suffice. *United States v. Coopers & Lybrand*, 550 F.2d 615, 621 (10th Cir. 1977); *United States v. Matras*, 487 F.2d 1271, 1275 (8th Cir. 1973) ("The term 'relevant' connotes and encompasses more than 'convenience.' . . . [T]he government failed to sustain its burden of proof by alleging a general need for a 'road map.'").

A court should not enforce these summonses unless authority for them exists in the following portions of 26 U.S.C. § 7602:

> "For the purpose of ascertaining the correctness of any return, . . . [or] determining the liability of any person for any internal revenue tax, . . . the Secretary is authorized—
>
> "(1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry; . . ."

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[2] *United States v. Coopers & Lybrand*, 413 F.Supp. 942, 950 (D.Colo. 1975), *aff'd*, 550 F.2d 615, 618 (10th Cir. 1977).

[3] *United States v. Arthur Andersen & Co.*, 623 F.2d 725, 729 (1st Cir. 1980).

The statute requires, first, a showing of potential relevance.[4] The matter to which the examined books or data must be potentially relevant is "such inquiry." It appears that Congress used "inquiry" here in the sense of "question," to refer to the *subject matter* inquired about rather than the process or performance of investigation to elicit the correct answer to the question.[5] Accordingly, "such

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[4] In the phrase "may be relevant or material," use of the words "may be" rather than "is" denotes that potential, as distinguished from actual, relevance is the test. Potential relevance is specified "since the Commissioner cannot be certain that the documents are relevant or material until he sees them." *United States v. Noall*, 587 F.2d 123, 125 (2d Cir. 1978), *cert. denied*, 441 U.S. 923, 99 S.Ct. 2031, 60 L.Ed.2d 396 (1979).

However, the words "may be" are *not* used to define the character of relationship denoted by "relevant," nor to attenuate or dilute the nexus that "relevant" implies. Rather, the expression "may be" serves merely to inform us that the Service need not establish in advance the existence of the requisite relevance or nexus to a certainty, but only to some lesser degree of likelihood. Moreover, "may be" tells us nothing about the identity of that to which the books and other data must be likely relevant.

The decisions do not make a distinction in this regard between "relevant" and "material." *See, e.g., United States v. Powell*, 379 U.S. 48, 57, 85 S.Ct. 248, 255, 13 L.Ed.2d 112, 119 (1964) (Commissioner "must show that the investigation will be conducted pursuant to a legitimate purpose, [and] that the inquiry may be relevant to the purpose, . . ."); *United States v. Wyatt*, 637 F.2d 293, 300 (5th Cir. 1981) ("must be pursuant to and relevant to a legitimate purpose"; "the test of relevancy").

[5] Section 7602(1) does not say relevant "to *making* such inquiry" or "to *performing* such inquiry," but simply "to such inquiry." And, if "inquiry" were used in the sense of the process or performance of investigation, then "necessary or convenient to" would be more appropriate wording than "relevant or material to." Indeed, to construe "inquiry" here as meaning the performance or process of investigation is necessarily to construe "relevant or material" as being the essential equivalent of "convenient." As noted, courts have consistently rejected such a construction. *United States v. Coopers & Lybrand, supra; United States v. Matras, supra. See also United States v. Arthur Young & Co.*, 496 F.Supp. 1152, 1157 (S.D.N.Y. 1980), *rev'd in part on other grounds*, 677 F.2d 211 (2d Cir. 1982).

inquiry" or "such question" is properly understood as referring to the question of "the correctness of any return" or "the liability of any person for any internal revenue tax." Thus, the section means that the books, papers, records or other data which the Service may summon are only those that it seeks because of their potential relevance to the *correctness* of a return or the *liability* of any person for a tax, as opposed to those the Service seeks merely because they have the potential of facilitating or making more efficient the process of examination. In this case, the IRS clearly seeks the tax pool analysis for the latter purpose, not the former.

I have no doubt that a congressional desire to promote effective and efficient tax determination and collection played a substantial part in the decision to grant the Service the summons power provided for in sections 7602 and 7603. Nevertheless, what Congress said in essence was not that the Service would have summons power whenever it might facilitate the examination process, but rather that the process of tax determination and collection would be enhanced and facilitated by giving the Service the power to summon records and other data that might be relevant to the correctness of returns or the liability of persons for taxes. After all, for a great many years the Service effectively employed its summons power in routine audits (such as that involved here) of large corporate taxpayers without the necessity of attempting to acquire their "tax pool" analyses. The practice of attempting in cases of this kind to summon the tax pool analysis is almost uniformly recognized as being both a qualitatively significant and a relatively recent expansion of the Service's prior practice. So far as I am aware, *Coopers & Lybrand* is the first appellate decision dealing with the question, and the instant case is the first appellate decision upholding the practice. One can hardly argue, then, that Congress must have intended to grant this power to the Service in enacting Section 7602 because without it that section would be substantially de-

ficient in providing for efficient and effective methods of ascertaining and collecting corporate taxes. In this connection, it is noteworthy that former Commissioner of Internal Revenue Mortimer Caplin, certainly a person fully familiar with the past practice and needs of the Service "should limit its requests to *only* those portions of the [tax pool analysis] workpapers containing *factual* information relevant to the tax audit." [6]

I recognize that this Court, in common with many others, has held that the general test for potential relevance of summonsed books or records is, as stated in *Foster v. United States*, 265 F.2d 183, 187 (2d Cir. 1959), *cert. denied*, 360 U.S. 912, 79 S.Ct. 1297, 3 L.Ed.2d 1261 (1960), "whether the inspection sought 'might have thrown light upon' the correctness of the taxpayer's returns." [7] *See United States v. Wyatt*, 637 F.2d 293, 300 (5th Cir. 1981). Nevertheless, virtually all these cases involve records sought because of their potential to provide *factual* information relating to the actual receipts, disbursements or transactions giving rise to the taxes in question.[8] That the taxpayer may not have based its re-

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[6] Caplin, *Should the Service Be Permitted to Reach Accountants' Tax Accrual Workpapers?*, 51 J. Tax. 194, 199 (1979) (emphasis added).

[7] However, so far as I am aware, this formulation has never been expressly adopted or approved by the Supreme Court.

[8] As observed in Note, *A Balancing Approach to the Discoverability of Accountants' Tax Liability Workpapers*, 60 Wash.U. L.Q. 185, 195-96 (1982):

> "Most of the courts construing relevance have dealt with records of the actual transactions that formed the basis of the income tax liability. The few cases in which the IRS has sought background materials that were either conjectural or only tangentially related to records of actual transactions have produced widely divergent results." (Footnotes omitted.)

For example, in *Wyatt* this Court pointed out:

> "The record clearly establishes that a prima facie showing of relevancy was made. Not only did the agent give examples of

turn on this information does not, of course, change either its *factual* nature or the character of its relevance to the actual correctness of the return.[9] Further, courts facing the summons question in different contexts have somewhat narrowed the definition of "relevant" to require "a realistic expectation rather than an idle hope that something may be discovered." *United States v. Harrington*, 388 F.2d 520, 524 (2d Cir. 1968); *United States v. Wyatt*, 637 F.2d at 300-01. Now, the courts are called upon to apply the relevancy test in yet another context, that of a summons of the tax pool analysis for aid in a routine audit where the summons is not sought to procure

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the types of transactions to which the questions were directed and how such transactions would affect the taxpayer's income tax liabilities, but detailed the need of the discovery and explanation of reported and unreported transactions." 637 F.2d at 301 (footnotes omitted).

[9] Thus, in *Noall* the Second Circuit approved a summons for a conventional internal audit (not a tax pool analysis) although it was not used in *preparing* the returns:

> "Clearly the purposes of the internal audit include the detection of overstatements or understatements of revenues or expenses. . . . If the internal auditors have ascertained an understatement of revennes or an overstatement of expenses, this plainly, might throw light on the correctness of the returns. . . . The Commissioner's interest lies in whether the tax returns correctly reflected [taxpayer] Bunge's actual income, not simply whether they were correctly prepared from the books of account and other records used." 587 F.2d at 126.

Obviously when the Court says "might throw light" it means the "light" thrown by factual data, *e.g.*, an "*ascertained* . . . understatement of revenues."

In *United States v. Euge*, 444 U.S. 707, 100 S.Ct. 874, 63 L.Ed.2d 141 (1980), the Court sustained a summons (under clause (3) of section 7602) requiring the taxpayer to appear and execute handwriting exemplars. Obviously, this did not relate to preparation of the returns being examined. Just as obviously, however, the relevance was *purely factual*—the agent was trying to verify whether the taxpayer was maintaining several bank accounts under aliases to conceal taxable income.

factual data. In this situation, I believe that "throw light upon" means throw *factual* light upon.[10]

The context in which "relevant" appears enhances the propriety of this construction. It is "books, papers, records, or *other* data" that must be potentially relevant. The word "other" suggests that the books, papers, and records referenced are those whose contents share common general characteristics with or are analogous to "data." As former Commissioner Caplin has aptly observed respecting section 7602(1):

> Little discussion has taken place on the scope of the word 'data' as contained in that Section. What comes to mind in the use of that term are items such as books, records and other factual materials—not opinions, projections, conjectures and other thought processes. Free access to accountants' tax accrual files, containing information of the second type, would be of obvious help to the IRS as a convenience, roadmap and time-saving device in carrying out its tax audit responsibility. But is it clear that Congress intended that all category of work product should be readily available to the IRS? Is there any evidence—to paraphrase Circuit Judge Sneed in *SEC v. Arthur Young & Co.*, 590 F.2d 785 (CA-9, 1979)—that Congress intended Section 7602 to be a 'conscription bill' to make the accounting profession 'an enforcement arm' of the IRS? It is hard to believe that even the most ardent in the IRS would strain the summons authority to fit the latter mold. As the Supreme Court reiterated in [*United States* v.] *Bisceglia*, 420 U.S. 141 [95 S.Ct. 915, 43 L.Ed.2d 88], (1975), the summons power of the IRS 'is a limited power and should be kept within its proper bounds.' Caplin, note 6 *supra*, at 199-200.

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[10] "Mental impressions, legal analysis, conclusions, and recommendations are generally not relevant." *P. T. & L. Construction Co. v. Comm'r*, 63 T.C. 404, 414 (1974).

Further, while *United States v. Powell*, 379 U.S. 48, 57-58, 85 S.Ct. 248, 255, 13 L.Ed.2d 112, 119 (1964), teaches us that section 7605(b)'s provision that "[n]o taxpayer shall be subjected to unnecessary examination or investigations" does not impose any character of "probable cause" requirement on the Service, the quoted language nonetheless appears to bespeak a congressional hostility to attenuated claims of relevance or to an expansion of "relevant" to include that which is in essence only for the convenience of the Service.

Of course, I recognize that the tax pool analysis may in some instances throw *factual* light upon the correctness of the return or the liability for tax. The opinions or knowledge of the taxpayer may be relevant *facts* in a fraud or negligence penalty case. And, it is not inconceivable that under certain circumstances the tax pool analysis may contain relevant factual data that is not otherwise available. A summons of the tax pool analysis for such a purpose would ordinarily meet the "may be relevant" test. However, under the *Powell* criteria, such information must not be "already within the Commissioner's possession," and must be potentially "relevant to the purpose" of the summons. 379 U.S. at 57-58, 85 S.Ct. at 254-55. Moreover, as noted, Congress has mandated that "[n]o taxpayer shall be subjected to unnecessary examination or investigation." 26 U.S.C. § 7605(b). Accordingly, we should not sustain a summons of a tax pool analysis, even if it may *incidentally* disclose some relevant data, when the Service's purpose, as here,[11] is *not* to elicit

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[11] During the course of this audit (which is presumably still in progress), the Service served on El Paso some 578 separate "Information Document Requests." Through August 1981, El Paso had complied with 529 of these; 29 were held for the agent to return or for additional information as to whether the agent in fact wanted the documents; 2 were later complied with; 5 were in some way involved in this proceeding. The IRS has not suggested any particular area for which it wishes to elicit information by its sum-

this data, but is rather to discover the taxpayer's post-return thought processes, theories, and opinions for use as a convenient road map in the performance of the audit of the return.

My views on the relevance of the tax pool analysis are, I believe, essentially those espoused by former Commissioner Caplin and are supported by the decision in *Coopers & Lybrand* and, inferentially, by the *Matras* opinion. I recognize, however, that they are at variance not only with those of my learned colleagues on this panel but also with those of the Second Circuit panel in *United States v. Arthur Young & Co.*, 677 F.2d 211 (2d Cir. 1982). Nevertheless, in *Arthur Young* a majority of the Court, recognizing the potentially far-ranging adverse consequences of its decision on relevance, felt it necessary to in effect create an auditor's work product privilege respecting the tax pool anlysis. In my view, the Second Circuit's concerns are better accommodated by refusing to give an overly broad construction to the necessarily somewhat imprecise and flexible criteria embodied in section 7602(1).

Accordingly, I would hold that the IRS made an insufficient showing of potential relevance, and would therefore reverse the judgment below.

I agree with the majority that "El Paso failed to particularize its assertion of the [attorney-client] privilege and prove its case with respect to any specific document," and with so much of the majority opinion as concerns the denial on this ground of El Paso's attempt to defeat the summonses by invoking the attorney-client privilege. I also believe that essentially the same reasoning dictates denial of El Paso's attempt to invoke blanket work product protection against these summonses.[12]

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monses of the tax pool analysis, or any particular need for the tax pool analysis other than as a convenient road map through the entirety of the returns being audited.

[12] However, I do not think the record here is sufficiently particularized to support the majority's apparent holding that *none* of

I am concerned, however, with the majority's holding that El Paso *waived* any possible attorney-client privilege. Not only is this holding unnecessary to the result reached, but this case presents a particularly unfortunate context within which to make such a determination of waiver. Because we really have no information whatever respecting any asserted attorney-client communication, determining whether the privilege in regard thereto has been waived is virtually impossible (which is another good reason to deny blanket assertions of the privilege).

The majority bases its waiver holding on the district court's finding [13] that El Paso "*discussed 'some* of the information and *many* of the potential tax liability issues' in the tax pool analysis with the independent auditors." (Emphasis added.) The majority then asserts that the auditors' task "carries" them "into the tax pool analysis and into at least *some* of the supporting memoranda," which are not confidential since "they are created with the knowledge that independent accountants *may need* access to them." (Emphasis added).[14]

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the tax pool analysis and backup memoranda are work product materials. Surely it is not unlikely that, for example, some of the backup materials include memoranda generated in anticipation of possible litigation with the IRS, and that portions of the tax pool analysis are supported by such memoranda. Indeed, such memoranda may relate to ongoing litigation respecting problems in earlier years that are repeated in or affect the years in question. Accordingly, while I do not agree with the apparent inference that "if it's in the tax pool analysis or backup it can't be work product," I nevertheless recognize that El Paso cannot achieve work product protection merely by invoking a blanket claim and suggesting purely hypothetical examples.

[13] I accept this finding, for the reasons stated by the majority.

[14] The majority may be factually in error here. I believe the record indicates that generally the auditors were *not* furnished the original or copies of the actual tax pool analysis and its backup "subject" documents. Certain of these items were *discussed* with the auditors (as indicated by the trial court's findings), and if they

But what of the supporting memoranda and items in the tax pool analysis that are *not* discussed with or shown to the auditors? (The evidence and findings below indicate such items exist, and indeed that a substantial number of the "subject files" fell into this category.) Moreover, even regarding a subject file or tax pool item that has been "discussed" with the auditors, the scope of the waiver would appear to depend on the scope of the discussion. Surely not every discussion relating to a topic included in a file mandates a waiver of the entirety of every item in that file.[16] Footnote 18 in *United States v. Davis*, 636 F.2d 1028, 1043 (5th Cir.), *cert. denied*, — U.S. —, 102 S.Ct. 380, 70 L.Ed.2d 162 (1981), is far too slender a reed to bear the full weight of such an extensive holding.[16] Nor does *United States v. Pipkins*, 528 F.2d 559, 563 (5th Cir.), *cert. denied*, 426 U.S. 952, 96 S.Ct. 3177, 49 L.Ed.2d 1191 (1976), provide significant guidance in this setting.[17]

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desired further investigation or verification beyond that provided by the discussion, they went to the regular company transaction records or summaries instead of into the tax pool analysis files.

[15] *See, e.g., United States v. Upjohn Co.*, 600 F.2d 1223, 1227 n.12 (6th Cir. 1979), *rev'd on other grounds*, 449 U.S. 383, 101 S.Ct. 677, 66 L.Ed.2d 584 (1981); *United States v. Lipshy*, 492 F.Supp. 35, 44 (N.D.Tex. 1979) (employee communications made to attorney in connection with preparing report for corporate client on corporate wrongdoing; held that disclosure of the report to the IRS and of portions of it to the SEC did not waive the privilege as to "all details underlying the statement").

[16] For example, a young man informs his mother that he was at the convenience store which was held up earlier in the evening. At her suggestion he sees Lawyer Jones, and on returning home his mother asks, "Did you tell Lawyer Jones you were at the store when it was held up?" He acknowledges that he did so. Has he thereby waived the privilege as to his entire conversation with Lawyer Jones respecting the occurrence at the store?

[17] *Pipkins* involved handwriting samples the client gave a handwriting expert retained by his attorney. This Court rejected a

Moreover, in my view substantial concerns argue in favor of holding that the attorney-client privilege is not waived by confidential disclosures to the client's independent auditors. Of course, as to information which the client intends the auditors to disclose to others or can anticipate a substantial possibility that such disclosure may be made in the proper fulfillment of the auditors' engagement, no such protection should exist. In a practical, operational sense the corporation and its outside auditor regard the information which the latter acquires in the course of its work, especially that within the scope of the attorney-client privilege, as fully confidential except insofar as the nature of the engagement contemplates the actual or likely disclosure of same to third parties. The reality of the matter is that for publicly held companies very little information can properly be held entirely confidential from independent auditors. If we do not take these realities into account in developing and applying theories of waiver of the attorney-client privilege in these situations, there is a substantial danger that the attorney-client privilege for publicly held corporations, so recently reaffirmed in *Upjohn Co. v. United States*, 449 U.S. 383, 101 S.Ct. 677, 66 L.Ed.2d 584 (1981), will become nothing but an empty theory. This danger is especially acute if courts broadly apply the concept of waiver of the entirety of a communication by the disclosure of any significant portion of it. Though informed by some of the same considerations, the suggestion here made does not create a new privilege or cover anywhere near as wide a range of communications as the rule adopted in *Arthur Young & Co.* Moreover, the restrictions on waiver hypothesized here are considerably narrower, and more in keeping with the

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claim of privilege, pointing out that Pipkins had "already voluntarily disclosed his handwriting style to the government," 528 F.2d at 563, and that "one's style of handwriting, readily observable by anyone, [is] not subject to the attorney-client privilege," 528 F.2d at 563 n.2.

concept of expected confidentiality, than the limited waiver approved in *Diversified Industries, Inc. v. Meredith*, 572 F.2d 596, 611 (8th Cir. 1977) (en banc), involving material disclosed to a public body.[18] And, there is no reason to believe that the courts will be any less able to control abuse of the privilege in this context than they have been in others. *See, e.g., United States* v. *Woodall*, 438 F.2d 1317, 1324 (5th Cir. 1970) (en banc), *cert. denied*, 403 U.S. 933, 91 S.Ct. 2262, 29 L.Ed.2d 712 (1971).

For these reasons I cannot accept the majority's blanket and unnecessary invocation of waiver of the attorney-client privilege in the context of this case.

The majority, as a part of its affirmance of the district court's judgment, lifts our previously granted stay of that judgment, in accordance with our normal practice. Of course, no motions for rehearing or for a continuation of the stay have been filed, and our mandate will not issue until action on a timely filed motion for rehearing, so the previously granted stay remains in effect at least until then. Accordingly, it is premature at this time to consider whether we should grant a further stay, and I do not understand the majority to prejudge that potential issue. I note, however, that compliance with the summons will moot further review, *United States v. Arthur Andersen & Co.*, 623 F.2d 720 (1st Cir. 1980), *cert. denied*, 449 U.S. 1021, 101 S.Ct. 588, 66 L.Ed.2d 483 (1980), that it does not appear a further stay will seriously affect the IRS, and that the instant decision, the first by an appellate court in upholding an IRS tax pool analysis summons, is

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[18] Under the *Meredith* limited-waiver approach, of course, the privilege does not extend to the governmental unit to which disclosure was made. *Cf. United States v. Miller*, 660 F.2d 563 (5th Cir. 1981) (in a criminal tax fraud case the attorney-client privilege was waived with respect to ledger books previously turned over to the IRS during its civil investigation respecting the taxes in issue). The *Meredith* limited-waiver theory was rejected in *Permian Corp. v. United States*, 665 F.2d 1214 (D.C. Cir. 1961).

essentially contrary to the Tenth Circuit's holding in *Coopers & Lybrand*. Under these circumstances a further stay may be proper even if it were determined that the applicant's chances of success on the merits are not sufficiently strong as to be deemed "probable." *See Ruiz v. Estelle*, 650 F.2d 555, 565-66 (5th Cir. 1981); *Providence Journal Co. v. FBI*, 595 F.2d 889 (1st Cir. 1979).

APPENDIX B

IN THE UNITED STATES DISTRICT COURT FOR
THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

Civil No. H-81-1360

UNITED STATES of AMERICA and
Revenue Agents CLARENCE H. ISBEL and JOHN S. REID
of the INTERNAL REVENUE SERVICE,
Petitioners

v.

THE EL PASO COMPANY,
Respondent

[Filed Nov. 30, 1981]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Petitioners, United States of America, Revenue Agent Clarence H. Isbel, and Revenue Agent John S. Reid, petitioned this Court to order enforcement of two Internal Revenue Service summonses, pursuant to Sections 7402 and 7604, Internal Revenue Code of 1954 (26 U.S.C.), against The El Paso Company. Respondent filed an Answer of the Petition and sought to take depositions of Internal Revenue Agents Isbel, Reid and S. T. Cano. The Court issued a protective order denying discovery unless a need for discovery was established at the hearing on the order to show cause why the Petition should not be granted. A hearing on the issues raised in the Petition and Answer was held on October 27 and 30, 1981 and November 3, 1981 and oral argument was heard on November 4, 1981. Petitioners Isbel and Reid, testified, and were cross-examined by respondent, at the hearing, and Revenue Agent Cano was present during the hearing but was not called to testify. Respondent has not requested

further discovery and has not demonstrated that discovery from these Revenue Agents would be, or would have been helpful to the presentation of its case. All parties were afforded full opportunity to be heard, to examine and cross-examine witnesses, to present evidence bearing on the issues, and to argue on the evidence and the law. The Court has fully considered the Petition, Answer, evidence, arguments, and briefs of counsel. Upon the entire record, the Court makes the following findings and conclusions.

Findings of Fact

1. Petitioners, United States of America, and Revenue Agents Clarence H. Isbel and John S. Reid, filed the petition herein for the judicial enforcement of two Internal Revenue Service summonses against respondent, The El Paso Company.

2. The two summonses were issued by Petitioner John S. Reid on February 13, 1980, and were served that day upon the agent of respondent, Jack D. McCarthy, identified in the summonses as Principal Tax Counsel, a position he held with The El Paso Company. The El Paso Company designated Mr. McCarthy as Audit Coordinator and specifically requested that the Internal Revenue Service restrict its communications regarding its examination of The El Paso Company, naming Mr. McCarthy and Letitia Farrell as the only persons to contact concerning The El Paso Company.

3. The El Paso Company, acting through its agent, Jack D. McCarthy, Director of Corporate Taxes for the El Paso Company, resisted the summonses and, as the real party in interest, was named as respondent in this proceeding. In addition to the usual defenses to summons enforcement, respondent raised the attorney-client privilege and work product rule with respect to both summonses.

4. The first summons (Gov. Ex. 1) required the production of "All internal audit reports, including all re-

lated workpapers and logs of such reports, for the period January 1, 1976, through December 31, 1978, inclusive."

5. The second summons (Govt. Ex. 2) required the production of "Any document, memorandum, letter, or workpapers which identify potential tax liabilities or tax problems for the period beginning January 1, 1976, and ending December 31, 1978, inclusive."

6. Petitioner Clarence H. Isbel is Case Manager of the Large Case Audit of The El Paso Company for the 1974-1975 cycle and the 1976-1978 cycle of an examination which has continued for many years. Petitioner John S. Reid is Audit Coordinator for the 1976-1978 cycle of the examination. The tax returns of The El Paso Company are extremely complex, involving the consolidation of returns of sixty-seven subsidiaries. The El Paso Company required more than 10,000 man-hours to prepare and file its 1977 consolidated income tax return. A number of the corporate subsidiaries are partners in complicated mining and manufacturing operations in various geographical locations. The examination of such tax returns is a formidable task.

7. Officials of The El Paso Company do not reveal tax problems or call attention to questionable items on its income tax returns, or volunteer any information to the Internal Revenue Service in identifying such items in the course of the examination. Conversely, officials of The El Paso Company reveal and discuss any such problem and items, which would materially affect its financial statements, with its independent auditors.

8. The two summonses were issued by Revenue Agent Reid as a part of the examination of federal tax liabilities of The El Paso Company for the years 1976, 1977, and 1978 by the Internal Revenue Service.

9. Mr. McCarthy appeared at the appointed time and place in the summonses on behalf of The El Paso Company and declined to comply with the two summonses, produc-

ing instead two letters which are a part of respondent's answer.

10. The examination of The El Paso Company's federal tax liabilities for the years 1976, 1977, and 1978 is being and has been conducted in good faith and in accordance with proper administrative and Internal Revenue Code procedures.

11. Unresolved tax issues were carried over into the 1976-78 cycle from the 1974-75 cycle. The 1974-75 cycle was still open at the time of the hearing. The Internal Revenue Service unsuccessfully attempted to obtain the same kinds of information with respect to the earlier cycle as it is seeking through the two summonses in issue here.

12. The two summonses required the production of documents and other records which would very likely be relevant to making a correct determination of federal income and excise tax liabilities of The El Paso Company for the years 1976, 1977 and 1978.

13. None of the agents of the Internal Revenue Service acted unreasonably, unlawfully, in bad faith, or in violation of any administrative procedures in conducting the examination of The El Paso Company or in issuing the two summonses.

14. The examination of The El Paso Company in the 1976-1978 cycle has been conducted in a reasonable and professional manner by the agents of the Internal Revenue Service, and no factual basis exists for the allegation made by The El Paso Company of bad faith on the part of the revenue agents.

15. The El Paso Company has not alleged, and there has been no evidence to show that the summonses were issued in furtherance of a criminal investigation.

16. The Internal Revenue Service does not have possession of the documents or other data sought through the two summonses.

17. The first summons (Govt. Ex. 1) required the production of documents which were prepared or compiled by agents and employees of The El Paso Company primarily for business purposes, and not for the rendering of legal advice or in preparation for litigation. The internal audit reports were created for the purpose of maintaining internal audit control, i.e., for use in detecting irregularities in the accounting function, or in creating or improving accounting systems. There may have been some special reports prepared for other than accounting-related purposes, but none have been specifically identified by The El Paso Company, either in response to a formal request for a list of such reports including date, purpose and subject matter made by the Internal Revenue Service on January 16, 1980, which request was denied, or during the presentation of its case in this matter.

18. Neither of the two witnesses called by The El Paso Company, General Counsel Thomas W. Curry and now Vice President-Taxes, Jack D. McCarthy, had reviewed any of the internal audit reports in preparing to testify.

19. The internal audit reports are retained by the Internal Audit Department. Glen Ruppert, an accountant, is in charge of that Department. General Counsel, the Tax Department and the independent auditors, Main, Hurdman & Co., have access to the internal audit reports and the information contained therein.

20. The second summons (Govt. Ex. 2) required the production of documents which were prepared or compiled by agents and employees of The El Paso Company primarily for business purposes, and not for the rendering of legal advice nor in preparation for litigation. Those documents, which The El Paso Company refers to at least in part as the "non-current tax account" file, were prepared for the purpose of determining the amount of potential tax liabilities which were to be shown as contingent liabilities on The El Paso Company's financial statements.

21. The El Paso Company's "non-current tax account" file contains approximately three or four accounting worksheets for each year on which there is a listing of items for each of which a contingent tax liability has been determined for the year. Memoranda and other documents relating to and identifying the items so listed may be contained in the non-current tax account file or in various other files under other subject headings. Such accounting worksheets for the years 1976, 1977 and 1978, and any memoranda or other documents which were prepared, compiled or utilized in developing the items listed on those worksheets, whether stored in the non-current tax account file or in some other place, come within the description of documents and other data required to be produced by the second summons.

22. The El Paso Company did not reveal the terminology it used for the "non-current tax account file" until after the hearing commenced. Accountants have no standard terminology for such a file. The language of the second summons was as specific as could be expected under the circumstances. The testimony of The El Paso Company's witnesses concerning the names and locations of various kinds of files and documents which might come within the second summons was vague. The El Paso Company's two witnesses, Thomas W. Curry and Jack D. McCarthy, did not review any documents in or related to the "non-current tax account" file of The El Paso Company in preparing to testify about the attorney-client privilege and the applicability of the attorney work product doctrine with respect to those documents. The El Paso Company was aware that the second summons required production of the "non-current tax account" file and related documents, at the least.

23. The El Paso Company may have prepared memoranda or other documents identifying potential tax liabilities with respect to issues which were considered for, but not included in, the "non-current tax account" list of

items. Such memoranda and other documents also come within the documents and other data described in the second summons.

24. The second summons requires The El Paso Company to produce documents or other data which relate to potential tax liability issues, that were prepared or compiled by or which were referred to the Tax Department of The El Paso Company, or to the superiors of the Tax Department. All documents or other data which were referred to, or which were prepared or compiled by, personnel of Tax Department, the Vice President—Taxes, Vice President—Finance, Executive Vice President, or President of The El Paso Company, which were prepared, compiled or utilized in determining the potential tax liabilities of The El Paso Company come within the description of documents and other data described in the second summons.

25. Some of the information and many of the potential tax liability issues contained in or identified in the internal audit reports and in the documents and other data described in the second summons were discussed with the independent accountants from Main, Hurdman & Co. All of said reports, documents, and other data were not intended to be kept confidential from the independent accountants. The El Paso Company made no attempt to identify any particular information which it actually withheld from the independent auditor.

26. The primary motivation of The El Paso Company in preparing or compiling the documents and other data described in the second summons was for business reasons, i.e., for the preparation of certified financial statements and financial planning, and not for the rendering of legal advice or for preparation for litigation.

27. The information contained in the documents and other data required to be produced by the two summonses was not intended by The El Paso Company to be kept

strictly confidential, but was intentionally revealed to persons who were not attorneys acting as attorneys or persons under such attorneys' control, and to persons other than for the purpose of rendering legal advice. Disclosure of such information was made to employees of The El Paso Company (some of whom were attorneys) acting in managerial and accounting capacities for business purposes, and disclosure was also made to independent auditors.

28. There is no evidence in the record which would support a finding that any particular document was prepared by an attorney acting as such, or by someone under such attorney's control, or for the purpose of rendering legal advice.

29. There is no evidence in the record which would support a finding that any particular document was prepared primarily in preparation for litigation.

30. The El Paso Company employs attorneys in its Tax Department and in the tax departments of certain of its subsidiaries. Some of the attorneys are not members of the State Bar of Texas. Some of the attorneys acted in a managerial rather than legal capacity in The El Paso Company's Tax Department.

31. Jack D. McCarthy, Director of Corporate Taxes and Audit Coordinator, commenced his employment with respondent in the Compliance Division (return preparation division) of The El Paso Company's Tax Department in August 1978. Several years earlier, he had been admitted to the bar in Michigan, and he is also licensed as a C.P.A. in Michigan. On January 4, 1979 Mr. McCarthy became licensed as a C.P.A. in Texas by reciprocity, but has not become a member of the State Bar of Texas. He was previously employed as an administrator for Phillips Petroleum in London, England. His employment with The El Paso Company has been primarily managerial. There has been no instance demonstrated where Mr. McCarthy

acted primarily or solely as an attorney, rather than as a manager or an accountant.

32. Thomas W. Curry, Executive Vice President and General Counsel, and former Vice President of Taxes for The El Paso Company, is a member of the Bars of New Mexico and Iowa bars, but is not a member of the State Bar of Texas.

33. The Tax Department is primarily responsible and reports to Mr. Mike Barcy, Vice President—Finance. Mr. Barcy is not an attorney.

34. The Internal Audit Department is under the control of Mr. Glen Ruppert, who is an accountant and not an attorney.

35. The entries which are considered for addition to the non-current tax account are discussed by various individuals, including persons who may be attorneys. Persons who are not attorneys and who are not necessary to assist the attorneys in rendering legal advice also take part in the discussions.

36. The non-current tax account is created so that The El Paso Company can prepare adequate financial statements and do financial planning. Mr. McCarthy's involvement in formulating the non-current tax account is primarily as a manager, and also as an accountant. Mr. McCarthy determines the materiality of an item of potential tax liability in terms of its effect on the earnings per share of the company rather than its effect on determining a correct tax liability for a particular year.

37. The two witnesses called by The El Paso Company, Thomas W. Curry and Jack D. McCarthy, did not review any document identifying potential tax liabilities or tax problems for the years 1976, 1977 and 1978 in preparing to testify.

38. The El Paso Company was aware prior to the hearing that a blanket assertion of attorney-client privi-

lege or work product privilege is not proper, and that such privileges must be established on a document-by-document basis. The El Paso Company's offer to provide documents at some later date for *in camera* inspection would only serve to delay this proceeding to the prejudice of petitioners.

39. The El Paso Company was aware prior to the hearing of the identity of at least the great majority, if not absolutely all, of the documents and other data described in the two summonses. The failure of The El Paso Company to have its witnesses review any such documents prior to the hearing, and the failure of The El Paso Company to attempt to meet its burden of proof with respect to the claimed privileges for each particular document cannot be justified.

40. The El Paso Company did not refuse its independent auditors access to any particular document or other data described in the two summonses. The independent auditors had access to each document or other data sought by the two summonses.

41. Because of the strong possibility that complex issues may be identified upon production of the documents sought by the two summonses, and because of the amount of other records located at places in various parts of the world which may require analysis or review in order to complete a thorough and fair examination of tax liabilities with respect to any such issue, at least ten months would be required after production of documents and other data pursuant to the two summonses is completed for the expeditious completion of the examination for the years 1976, 1977 and 1978.

42. Any conclusion of law more properly denominated a finding of fact, in whole or in part, is hereby adopted in pertinent part as a finding of fact.

Conclusions of Law

1. This Court has jurisdiction of the parties and of the subject matter of this proceeding under Sections 7402(b) and 7604, Internal Revenue Code of 1954 (26 U.S.C.), and is empowered thereby to compel compliance with such summonses.

2. This proceeding is governed by Rule 81(a)(3), Federal Rules of Civil Procedure. While essentially a summary procedure, respondent raised an attorney-client privilege and work product privilege with respect to the documents sought to be produced, and respondent was given full opportunity to prove such privileges at the hearing.

3. Respondent, The El Paso Company, is the real party in interest with respect to the enforcement of the two summonses.

4. The examination of the federal excise and income tax liabilities of The El Paso Company for the years 1976, 1977 and 1978 is a legitimate exercise of the authority granted to the Internal Revenue Service under the Internal Revenue Code of 1954.

5. The petitioners have overwhelmingly met their burden of proof with respect to the criteria established in *United States v. Powell*, 379 U.S. 48, 57-58 (1964).

6. Respondent failed to present any credible evidence which would tend to establish that any of the *Powell* criteria were not satisfied by petitioner.

7. Respondent's contention that the petition fails to state a claim upon which relief can be granted was not addressed by respondent during the hearing or otherwise except for being alleged in its Answer. The Petition states a valid claim upon which relief can and should be granted.

8. The summonses require production of documents and other data which would very likely be relevant to carrying out the legitimate purpose of the examination being conducted by the Internal Revenue Service. Respondent's reliance on *United States v. Coopers & Lybrand*, 550 F. 2d 615 (10th Cir. 1977) in this regard is not well-founded. Its holding was based on an erroneous assumption that only documents used in the preparation of tax returns can be relevant to a tax examination. That holding has been criticized and rejected by other courts, and is also rejected by this Court.

9. Production of the documents sought by the summonses in this case is necessary to the accomplishment of an effective examination, and would not be merely an extravagant convenience for which the burden of production on the taxpayer would outweigh the potential benefit of the Internal Revenue Service. The audit of such a large corporation, being a formidable task in itself, should not be hindered by requiring the Internal Revenue Agents to reconstruct, recreate, and speculate about non-privileged information which was already made available to outsiders by the taxpayers. Such a burden places too great a strain on our voluntary system of tax collection and might encourage unscrupulous taxpayers to take advantage of the unnecessary secrecy such a policy would create. In this regard the information the Internal Revenue Service obtains can be disclosed only for limited purposes, under Section 6103, Internal Revenue Code of 1954. The independent auditors have access to the information sought by the summonses for the protection of investors. The Internal Revenue Service should have at least equal access to protect the fisc, provided of course the *Powell* tests are met.

10. The summonses adequately describe the documents and other data to be produced. The general nature of the description is caused by respondent's secrecy, but is sufficiently precise to satisfy the need for particularity.

11. The summonses do not call for production of documents or other items beyond those which are reasonably related to the legitimate scope of the tax examination. No undue burden is created by the summonses.

12. The provisions of the Internal Revenue Code have not been violated by the examination or in issuing the two summonses.

13. The guidelines with respect to issuance of a summons for tax accrual workpapers are not relevant to a determination of the enforceability of these summonses.

14. While not relevant, petitioners did not violate such guidelines in issuing these summonses. The guidelines promulgated in May 1981 did not apply to the issuance of these summonses in February 1980.

15. No bad faith or unlawful purpose for the summonses has been established and no reasonable basis for such an allegation is found in the record.

16. Access to records and documents used in the preparation of income tax returns is mandated by Section 6001, Internal Revenue Code of 1954 (26 U.S.C.), and the regulations thereunder. Providing such records to the Internal Revenue Service does not preclude the use of a summons for production of records which were not used in preparing the tax returns. Nor does providing such records result in the constructive possession of the Internal Revenue Service of documents and other data derived from the records provided.

17. Respondent raised an attorney-client privilege and an attorney work product defense in its answer with respect to all documents sought by the summonses, and raised the attorney-client privilege in its letter of March 4, 1980 (Govt. Ex. 5) which it submitted in refusing to comply with the second summons. Such defenses were appropriately raised and can be ruled upon in this proceeding.

18. Respondent had the burden of proof to separately establish that the claimed privileges were applicable to each document or other item with respect to which it asserted such privileges.

19. Respondent did not seriously attempt to meet its burden of proof to establish its claim of attorney-client privilege and work product privilege for any particular document. Blanket assertions of privilege are not acceptable. Respondent knew of its burden to particularize its proof but failed to do so. Respondent's claim of not knowing what documents are sought by the summons is not credible, and even if respondent might have had some doubt as to whether a certain document fell squarely within one of the descriptions in the summons, it had a duty to meet its burden with respect to the substantial number of documents which were and are clearly within the scope of the summonses. The fact that the company had offices in various parts of the world which might certain documents unknown to the Tax Department, but arguably within the scope of either summons, did not excuse respondent from reviewing the pertinent documents of the Tax Department and Internal Audit Department so that a document-by-document test of its privilege claims could be made.

20. Petitioners have taken the position that, under the second summons, it desires only those documents which were prepared or compiled in the Tax Department of The El Paso Company, or its superiors, or were referred to the Tax Department, or its superiors. This is a reasonable construction of the language of the second summons, and if it could be considered a narrowing or a limitation of the second summons, such limitation or narrowing is reasonable.

21. The El Paso Company did not assert any claim of not understanding the second summons in its two-page refusal letter of March 4, 1980. Nevertheless, petitioners made their request even more clear in their memorandum

of law hand-delivered to respondent on September 21, 1981. Respondent's response of September 24, 1981 shows that it understood what kind of documents were sought by the Internal Revenue Service in its second summons.

22. Respondent has raised the possibility that some documents *may* exist in far-away offices which *may* be within the description of the second summons as its excuse for not attempting to meet its burden of proof with respect to documents obviously within the summonses. Respondent made a tactical decision to merely assert a blanket privilege, a decision aimed at causing delay and confusion. Its tactic has had the practical effect of waiving whatever privilege might have existed with respect to each document which is within the scope of the summonses.

23. Respondent offered to deliver numerous documents to the Court at some future date for *in camera* inspection for the purposes of establishing privilege. None of such documents have been identified by respondent with any kind of particularity. Such a procedure would not only be unduly burdensome on the Court, it would deny petitioners an opportunity to cross-examine with respect to the hearsay nature of such documents. Even if a particular document appeared on its face to be privileged, there would be no way for the Court to decide whether it met the various criteria for the attorney-client privilege or the work product rule, except from self-serving hearsay of the document itself.

24. Even if certain of the documents were prepared by attorneys for legal advice, the record amply demonstrates that the substance of the communications in such documents was either openly discussed with independent auditors or would have been discussed had the issue been raised. Only non-material issues were not discussed. This refutes the confidentiality aspect of the attorney-client privilege.

25. None of the documents described in the summonses has been established as having been created primarily in preparation of litigation.

26. The participation of an attorney in the preparation of a report or other document does not necessarily establish that the report or document was prepared for legal advice. Respondent has not established that any report, document or other item described in the summonses was prepared by an attorney acting as an attorney, or by someone acting under such attorney's control.

27. The general principles of the attorney-client privilege and the work product privilege would not be furthered by a finding that the reports, documents and other items sought by the summonses were privileged.

28. There should be no stay of enforcement pending appeal of the enforcement order because petitioners have overwhelmingly established their right to have the summonses enforced, while respondents have failed to present credible evidence sufficient to establish any good reason why the summonses should not be enforced. Furthermore, it appears that respondent's litigation tactics are motivated by a desire to cause confusion and delay rather than an orderly resolution of the issues.

29. And finding of fact more properly denominated a conclusion of law, in whole or in part, is hereby adopted in pertinent part as a conclusion of law.

/s/ Woodrow Seals
United States District Judge

Signed at Houston, Texas on November 30, 1981.
W.E.

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 81-2484

D. C. Docket No. CA-H-81-1360

UNITED STATES of AMERICA and
Revenue Agents CLARENCE H. ISBEL and JOHN S. REID
of the INTERNAL REVENUE SERVICE,
Petitioners-Appellees,

versus

THE EL PASO COMPANY,
Respondent-Appellant.

Appeal from the United States District Court for the
Southern District of Texas

[Filed Sep. 30, 1982]

Before GOLDBERG, WILLIAMS and GARWOOD, Circuit Judges.

JUDGMENT

This cause came on to be heard on the record on appeal from the United States District Court for the Southern District of Texas, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, affirmed;

IT IS FURTHER ORDERED that respondent-appellant pay to petitioners-appellees, the costs on appeal to be taxed by the Clerk of this Court.

August 13, 1982

GARWOOD, Circuit Judge, dissenting.

ISSUED AS MANDATE: Sep 27 1982

APPENDIX D

UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 81-2484

UNITED STATES of AMERICA and
Revenue Agents CLARENCE H. ISBEL and JOHN S. REID
of the INTERNAL REVENUE SERVICE,
Petitioners-Appellees,

versus

THE EL PASO COMPANY,
Respondent-Appellant.

Appeal from the United States District Court for the Southern District of Texas

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ON PETITION FOR REHEARING AND SUGGESTION FOR REHEARING EN BANC

(Opinion 8/13/82, 5 Cir., 198—, —— F.2d ——)

(September 15, 1982)

Before GOLDBERG, WILLIAMS and GARWOOD, Circuit Judges.

PER CURIAM:

( ) The petition for Rehearing is DENIED and no member of this panel nor Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc, (Rule 35 Federal Rules of Appellate Procedure; Local Fifth Circuit Rule 16) the Suggestion for Rehearing En Banc is DENIED.

(XX) The Petition for Rehearing is DENIED and the Court having been polled at the request of one of the members of the Court and a majority of the Circuit Judges who are in regular active service not having voted in favor of it, (Rule 35 Federal Rules of Appellate Procedure; Local Fifth Circuit Rule 16) the Suggestion for Rehearing En Banc is also DENIED.

( ) A member of the Court in active service having requested a poll on the reconsideration of this cause en banc, and a majority of the judges in active service not having voted in favor of it, rehearing en banc is DENIED.

ENTERED FOR THE COURT:

/s/ Jerre S. Williams
United States Circuit Judge

APPENDIX E

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

Civil No. H-81-1360

UNITED STATES of AMERICA and
Revenue Agents CLARENCE H. ISBEL and JOHN S. REID
of the INTERNAL REVENUE SERVICE,
Petitioners

v.

THE EL PASO COMPANY,
Respondent

[Filed Nov. 30, 1981]

JUDGMENT

This action came on for hearing on an Order to Show Cause why respondent, The El Paso Company, should not be compelled to obey two summonses served February 13, 1980, upon respondent by Petitioner John S. Reid, Revenue Agent, Internal Revenue Service, before the Court, Honorable Woodrow Seals presiding, and the issues having been duly heard and the findings of the Court having been duly rendered by the Court on this date, it is

ORDERED and ADJUDGED that The El Paso Company shall designate and require Jack D. McCarthy, and such other officers and managerial employees as it desires, to appear before Petitioner Clarence H. Isbel or Petitioner John S. Reid at the offices of Examination Division, Internal Revenue Service, Room 4000, 515 Rusk, Houston, Texas, and to produce documents and other items, and give testimony relating to the federal tax liabilities of The El Paso Company for the years 1976, 1977, and 1978, in accordance with the following schedule:

1. As 1 p.m. on the 7th day of December, 1981, to give testimony and to produce:

(a) all internal audit reports of The El Paso Company, and all related workpapers and logs of such reports, for the years 1976, 1977 and 1978; and

(b) the "non-current tax account" file of The El Paso Company identifying potential tax liabilities, including all documents or other data which were prepared, compiled or utilized in determining the potential tax liabilities with respect to the items in said file, for the years 1976, 1977 and 1978, which were physically present in the offices of The El Paso Company in Houston, Texas on November 4, 1981.

2. At 1 p.m. on the 7th day of December, 1981, to give testimony and to produce all documents or other data specified in paragraph 1(b), above, notwithstanding where such items were located on November 4, 1981.

3. At 1 p.m. on the 7th day of December, 1981, to give testimony and to produce all documents or other data which relate to and identify potential tax liabilities of The El Paso Company, for the years 1976, 1977 and 1978, which documents or other data were referred to, or which were prepared or compiled by, the Tax Department, the Vice President-Taxes, the Vice President-Finance, Executive Vice President, or President of The El Paso Company, excluding documents or other data which have been produced pursuant to this Judgment.

It is further ORDERED and ADJUDGED that the oral motion for a stay of the execution of this Judgment compelling respondents to obey the summonses is denied, in that respondent has proved no facts to estab-

lish any reasonable basis for appeal of this Judgment, and

It is further ORDERED that Petitioners Clarence H. Isbel and John S. Reid, and Internal Revenue Agent S. T. Cano, are each specially appointed to serve a copy of this judgment upon The El Paso Company by handing a copy of it to Jack D. McCarthy, Vice President, or, in the alternative, by any manner of delivery of a copy permitted under Rule 5(b), Federal Rules of Civil Procedure.

ENTERED this 30th day of November, 1981.

/s/ Woodrow Seals
United States District Judge

APPENDIX F

SUMMONS

In the matter of the tax liability of
The El Paso Company
2727 Allen Parkway
Houston, Texas 77019

Internal Revenue District of Austin

Periods January 1, 1976, thru December 31, 1978

The Commissioner of Internal Revenue

To Jack D. McCarthy, Principal Counsel, Tax
2727 Allen Parkway

At Houston, Texas 77019

You are hereby summoned and required to appear before Clarence H. Isbel, an officer of the Internal Revenue Service, to give testimony relating to the tax liability or the collection of the tax liability of the person identified above for the periods shown and to bring with you and produce for examination the following books, records, papers, and other data:

> Any document, memorandum, letter, or workpapers which identify potential tax liabilities or tax problems for the period beginning January 1, 1976, and ending December 31, 1978, inclusive.

Business address and telephone number of Internal Revenue Service officer named above:
515 Rusk Avenue, 4th Floor, Room 4000,
Houston, Texas 77002

Place and time for appearance:

at 515 Rusk Avenue, 4th Floor, Room 4000,
Houston, Texas 77002
on the 4th day of March, 1980 at 10:00 o'clock A.M.

Issued under authority of the Internal Revenue Code
this 13th day of February, 1980

/s/ John S. Reid
Signature of Issuing Officer
Internal Revenue Agent
Title

Part A—To be given to person summoned

APPENDIX G

THE EL PASO COMPANY

2727 Allen Parkway
P.O. Box 2185
Houston, Texas 77001
Phone: 713-525-9400

JACK D. MCCARTHY
Director of Corporate Taxes

March 4, 1980

Mr. Clarence H. Isbel
515 Rusk Avenue
Fourth Floor, Room 4000
Houston, Texas 77002

Re: The El Paso Company
Tax Years 1976, 1977 and 1978
Administrative Summons for Analyses of
Potential Tax Liabilities

Dear Mr. Isbel:

On behalf of The El Paso Company, and in response to your administrative summons dated February 13, 1980, notice is hereby given that I respectfully decline to comply with the summons of any document, memorandum, letter or workpapers which identify potential tax liabilities or tax problems for the period beginning January 1, 1976 and ending December 31, 1978, inclusive.

It is respectfully contended under Section 7602 of the Internal Revenue Code of 1954, as amended, that such documents or workpapers are not relevant or material to any legitimate inquiry of the Internal Revenue Service for the tax years involved. Additionally, it is the position of The El Paso Company that the standards for

judicial enforcement of an administrative summons as identified in *United States v. Powell*, 379 U.S. 48 (1964), cannot be met by the government. Specifically, the taxpayer contends that the documents or workpapers being sought are not relevant to any legitimate purpose of the Internal Revenue Service in examining the taxpayer's income tax returns for the years involved. Even if such reports were deemed to be relevant, it is the taxpayer's position that the information contained in such documents or workpapers is already in the possession of the Internal Revenue Service as a result of the taxpayer having previously provided the Internal Revenue Service with complete access to all business records and documents used in the preparation of the income tax returns of The El Paso Company for years 1976, 1977 and 1978.

In addition, it is the taxpayer's position that the decision in *United States v. Coopers & Lybrand*, 413 F. Supp. 942 (D.C. Colo., 1975), aff'd 550 F.2d 615 (10th Cir. 1977), wherein the court squarely faced the issue of the Internal Revenue Service's access to the tax accrual or "tax pool analysis files", would preclude the Internal Revenue Service from being successful in its attempt to enforce its administrative summons for the taxpayer's potential tax liability analysis files. The facts involved in the *Coopers & Lybrand* case are substantially identical to those involved here. Even though in the *Coopers & Lybrand* case the Internal Revenue Service was seeking the "tax pool analysis files" contained in the taxpayer's independent public accounting firm's work papers and not the "tax pool analysis files" in the possession of the taxpayer itself, that distinction is not important since the taxpayer in that case prepared that analysis (and the District Court found that the analysis contained the ideas, analyses, theories and accounting and legal opinions of the taxpayer's tax personnel), and provided that analysis to its independent public account-

ing firm for inclusion in that firm's "tax pool analyses file."

Furthermore, the District Court in *Coopers & Lybrand* held that where the "tax pool analysis files" were not prepared in connection with or used to facilitate the preparation and filing of the corporate taxpayer's federal income tax returns and where the "tax pool analysis files" contained highly speculative and conjectural information pertaining to, among other things, estimates of the corporate taxpayer's contingent liability for future taxes based upon opinions and projections of the taxpayer's tax personnel, the "tax pool analysis files" were not sufficiently relevant to the investigation of the corporate taxpayer's tax liabilities for the years involved to warrant enforcement of the Internal Revenue Service's summons to compel the taxpayer's independent public accounting firm to produce such files. Also, it is the opinion of the taxpayer that the language of the Tenth Circuit, in its opinion affirming the District Court's decision, wherein it stated that it is "worthy of repeating . . . that the tax pool analysis file was not prepared in connection with or used to facilitate the preparation and filing of [the taxpayer's] tax returns", further supports its argument that the Internal Revenue Service would be unsuccessful in its attempt to enforce its administrative summons for the taxpayer's potential tax liability analyses files sinch such information was not used by The El Paso Company in the preparation and filing of its corporate tax returns for the years under examination.

Finally, it is also respectfully contended that the information being sought by this summons is protected from examination by the Internal Revenue Service by the attorney-client privilege since the information being sought was prepared by, or directly under the supervision of, an attorney or attorneys employed by The El Paso Company.

Having appeared at the time and place and before the Internal Revenue Service officer designated in the summons dated February 13, 1980, notice is hereby given that The El Paso Company in good faith challenges such summons and does not intend to comply with the summons for the reasons stated herein.

Respectfully submitted,

/s/ JACK D. MCCARTHY

JDM/lb

Supreme Court, U.S.
FILED
JAN 14 1983
ALEXANDER L. STEVAS
CLERK

No. 82-716

In the Supreme Court of the United States

OCTOBER TERM, 1982

EL PASO COMPANY, PETITIONER

v.

UNITED STATES OF AMERICA, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES

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QUESTIONS PRESENTED

1. Whether a tax pool analysis, prepared by a corporation's employees in the ordinary course of its business, for the purpose of determining the amount of the corporation's reserve for contingent tax liabilities, "may be relevant" within the meaning of 26 U.S.C. 7602(1), to an Internal Revenue Service audit of the corporation to determine its federal income tax liabilities and therefore subject to production in response to an internal revenue summons.

2. Whether a corporation's tax pool analysis is privileged from disclosure in response to an internal revenue summons issued under 26 U.S.C. 7602.

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BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-42a) is reported at 682 F.2d 530. The opinion of the district court (Pet. App. 63a-65a) is not reported.

JURISDICTION

The judgment of the court of appeals was entered on August 13, 1982 (Pet. App. 59a-60a). A timely petition for rehearing with suggestion for rehearing en banc was denied on September 18, 1982 (Pet. App. 61a-62a). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTES INVOLVED

The provisions of Section 7602 of the Internal Revenue Code of 1954 (26 U.S.C.) are set forth at Pet. 2.

STATEMENT

1. Petitioner is a Texas holding company with 67 subsidiary corporations. Its stock is publicly traded on the New York Stock Exchange (Pet. App. 2a). Federal securities laws require that companies subject to those laws file certified financial statements with the Securities and Exchange Commission on a regular basis. See 15 U.S.C. (& Supp. V) 78c and 15 U.S.C. 78*l*. These financial statements are prepared in accordance with generally accepted accounting and auditing standards and are required to contain a reserve for contingent federal income tax liabilities. Moreover, banks that lend to publicly held corporations may also require that such a reserve be maintained and included in corporate financial statements submitted in connection with loan applications (Pet. App. 5a-6a). Each year, the amount of the contingent liability reserve is computed from an analysis of the corporation's tax returns. Every item on the income tax return that could reasonably be subject to challenge by the Internal Revenue Service is analyzed and an estimate of the corporation's potential exposure for additional taxes is assigned to that item. The total of the estimated amounts assigned to the individual items is the amount of the reserve for contingent future tax liabilities (*ibid.*). The documents utilized in the preparation of the reserve are known by various names, including tax pool analysis, the noncurrent tax account, or tax accrual workpapers (*id.* at 6a).

Although the tax pool analysis for some corporations may be prepared by independent certified public accountants during an audit and certification process, petitioner's own employees in its tax department prepared the tax pool analysis and computed petitioner's contingent tax liability reserve. With respect to each item on the tax return identified as potentially subject to challenge by the Internal Revenue Service, the accounting branch of petitioner's tax

department prepared a memorandum or memoranda discussing the item and the tax treatment accorded it. These memoranda were maintained in various "subject" files in the tax department (Pet. App. 9a). On the basis of these memoranda, petitioner's personnel estimated the corporation's potential tax exposure with respect to each item. Thereafter, petitioner's employees summarized these estimates on worksheets. The four or five worksheets generated by petitioner's tax department each year and the various memoranda supporting the estimates appearing on the worksheets comprise petitioner's tax pool analysis or tax accrual workpapers (*id.* at 9a-10a).

The independent certified public accountants who audit and certify petitioner's financial statements discussed the tax accrual reserve with petitioner's personnel during the conduct of the audits (Pet. App. 49a). During the years in issue (1976, 1977 and 1978), these discussions focused on the fairness and adequacy of the reserve amount (*id.* at 3a, 17a, 49a).

As part of the audit of petitioner's returns for 1976 through 1978, the Internal Revenue agents conducting the audit requested petitioner to provide them with its tax pool analysis. Upon petitioner's refusal to provide those items, an agent issued an internal revenue summons. Petitioner refused to produce the tax pool analysis on the ground that it was not relevant to the Service's investigation. It also contended that the documents were protected by the attorney-client privilege or attorney work-product doctrine because the tax pool analysis "was prepared by, or directly under the supervision of, an attorney or attorneys employed by" petitioner (I-R. 19-20).[1]

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[1] "R." refers to the five-volume record on appeal.

2. In this proceeding to enforce the summons brought by the government in the United States District Court for the Southern District of Texas, the district court ordered the summons enforced (Pet. App. 43a-58a). In so ruling, the court rejected petitioner's claims that the materials were not relevant to the Service's investigation, or that they were, in any event, protected by any privilege. It concluded that the government had made a sufficient showing of relevance to meet the standard required by *United States* v. *Powell*, 379 U.S. 48, 57-58 (1964), and that petitioner had "failed to present any credible evidence" to the contrary (Pet. App. 53a). The court found that the information summoned "would very likely be relevant to * * * the examination being conducted by the Internal Revenue Service" (*id.* at 54a).

The district court also rejected petitioner's defenses based upon the attorney-client privilege and attorney work-product doctrine. It found that there was "no evidence in the record which would support a finding that any particular document was prepared by an attorney acting as such, or by someone under such attorney's control, or for the purpose of rendering legal advice[,] * * * [or] primarily in preparation for litigation" (Pet. App. 50a). Although the director of petitioner's tax department was an attorney, the court found that petitioner had failed to demonstrate a single instance in which that corporate official had acted as an attorney, rather than as a manager or an accountant (*id.* at 50a-51a). Noting that petitioner bore the burden of proof to establish its claim of attorney-client privilege, the district court found that, apart from a blanket assertion, petitioner had made no serious attempt to establish its claim (*id.* at 56a). Accordingly, the court concluded that the policies behind the privilege and the attorney work-product doctrine "would not be furthered" by sustaining the claim of privilege in this instance (*id.* at 58a).

Finally, the court concluded that, even assuming that the documents were privileged when they were created, the record amply demonstrated that the substance of the communications in the documents was either openly discussed with independent auditors or would have been discussed had the issue been raised. These discussions indicated an absence of any intention to maintain confidentiality and were therefore sufficient to destroy the confidentiality necessary to sustain the privilege (Pet. App. 57a).

3. The court of appeals affirmed, with one judge dissenting (Pet. App. 1a-42a). It likewise rejected the argument that the tax pool analysis was not relevant to the income tax audit. As the court of appeals concluded, it was "in fact, hard to imagine a document more likely to shed light on the correctness of * * * [questionable] aspects of a return * * * than the tax pool analysis" (*id.* at 12a). In ruling that the tax accrual papers were relevant, the court noted that its "holding accords with the similar conclusion on the relevance of tax-accrual work papers recently reached by the Second Circuit in *United States* v. *Arthur Young & Co.*, 677 F.2d 211 (2d Cir. 1982)" (Pet. App. 12a).[2]

The court of appeals also ruled that the attorney-client privilege was inapplicable. First, it upheld the district court's factual finding that petitioner's employees discussed some of the information contained in the tax pool analysis with the company's outside auditors. It therefore ruled that (Pet. App. 17a-18a) since confidentiality was "neither expected nor preserved" with respect to the tax pool

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[2]Although the court in *Arthur Young & Co.* declined to enforce the summons on the ground that the tax accrual papers were privileged, the court below distinguished *Arthur Young* on the ground that the accountant work product privilege is inapplicable to papers summoned from the taxpayer itself, rather than from outside accountants (see Pet. App. 12a n.7).

analysis, the privilege, which applies only to confidential communications, could not be sustained. As the court saw the matter, the discussions between petitioner's employees and the accountants regarding the tax pool analysis destroyed the confidentiality necessary to sustain a claim of the attorney-client privilege (*id.* at 19a). It concluded that to hold otherwise would require establishment of an accountant-client privilege that is not recognized under federal law (*ibid.*). The court also rejected petitioner's claim of attorney-client privilege on the ground that petitioner made only a blanket assertion of the privilege that was inadequate to sustain its burden of proof with respect to any specific document (*id.* at 20a).

Finally, the court held that the attorney work-product doctrine did not protect against the disclosure of the tax pool analysis. Even on the assumption that petitioner's tax pool analysis otherwise constituted attorney work product, the court concluded that the doctrine did not bar its disclosure because no part of it was prepared in anticipation of litigation. Rather, it was prepared in the ordinary course of petitioner's business (Pet. App. 24a-25a). The court also found unpersuasive petitioner's contention that the public policies requiring full disclosure to independent accountants contained in the securities laws mandated protecting the tax pool analysis. Characterizing as "wholly speculative" (*id.* at 27a) petitioner's assertion that protection was necessary to encourage full corporate disclosure to auditors, the court of appeals found no policy clash between the securities laws and the summons authority granted to the Commissioner by Section 7602 of the 1954 Code.[3]

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[3]Judge Garwood dissented from the court's holding that the government had made a sufficient showing that the tax pool analysis was relevant to the audit of the return to obtain enforcement of the summons (Pet. App. 36a-37a). While he also dissented (*id.* at 38a-41a)

ARGUMENT

Petitioner seeks review of the decision below enforcing an internal revenue summons requiring it to produce its tax pool analysis and certain supporting documentation. The petition presents two questions: (1) whether the tax pool analysis may be relevant under 26 U.S.C. 7602 to the Internal Revenue Service's investigation of petitioner's tax liability; and (2) whether the tax pool analysis is, at all events, protected from disclosure under either the attorney-client privilege or work-product doctrine.

1. *Relevancy.* a. Petitioner contends (Pet. 11-14) that its tax pool analysis, which contains its "assessment of the questionable positions it took on its return" (Pet. App. 11a), is not relevant to the Service's investigation of its tax liability because the documents were not prepared in connection with the tax return, but rather were developed for financial reporting purposes. But the standard of relevancy does not depend upon whether the information sought was used in connection with the preparation of the taxpayer's returns. In *United States* v. *Powell*, 379 U.S. 48, 57-58 (1964), this Court held that in order to obtain enforcement of a internal revenue summons, the government must show, inter alia, that the summoned material may be relevant to the inquiry. The courts of appeals have uniformly held that in order to meet the *Powell* requirement, the government need make only a "minimal" showing of relevancy and that an allegation in an affidavit of the agent who issued the summons that the summoned material is relevant is sufficient to

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from the ruling that any attorney-client or work-product privilege had been waived because some of the contents of the tax pool analysis were discussed with the accountants. Judge Garwood agreed with the court's conclusion that petitioner had failed to particularize its claims of privilege and had therefore failed to carry its burden of establishing that either the privilege or the work product doctrine protected the tax pool analysis (*id.* at 37a).

establish a prima facie case under *Powell*. Once such a showing is made, the burden shifts to the party challenging the summons to establish that the summoned material is not relevant to the determination of tax liabilities. See, e.g., *United States* v. *Kis*, 658 F.2d 526 (7th Cir. 1981), cert. denied, No. 81-1272 (Mar. 22, 1982); *United States* v. *City National Bank & Trust Co.*, 642 F.2d 388, 389 (10th Cir. 1981); *United States* v. *Moon*, 616 F.2d 1043, 1046 (8th Cir. 1980); *United States* v. *Garden State National Bank*, 607 F.2d 61, 68-70 (3d Cir. 1979); *United States* v. *Noall*, 587 F.2d 123, 125-126 (2d Cir. 1978), cert. denied, 441 U.S. 923 (1979).

The terms of the pertinent statute — Section 7602(1) —support a broad standard of relevancy. In that provision, Congress has authorized the Commissioner of Internal Revenue "[t]o examine any books, papers, records, or other data which *may be* relevant or material to [his] inquiry" (emphasis added). As Judge Friendly observed in *United States* v. *Noall*, 587 F.2d 123, 125 (2d Cir. 1978), cert. denied, 441 U.S. 923 (1979), "Congress acted advisedly in using the verb 'may be' rather than 'is', since the Commissioner cannot be certain that the documents are relevant or material until he sees them." What is more, the scope of the authorized inquiries is likewise broadly cast to include "ascertaining the correctness of any return, making a return where none has been made, [and] determining the liability of any person for any internal revenue tax * * *" (26 U.S.C. 7602).

Thus, the fact that particular material may not have been used in the preparation of the taxpayer's return does not, as petitioner would have it, insulate it from compelled production. Such material nevertheless "may be relevant or material to [the Commissioner's] inquiry" within the meaning of Section 7602(1). Indeed, this Court has upheld the enforcement of summonses to produce material that was not used

in the preparation of the audited returns. See, e.g., *United States* v. *Euge*, 444 U.S. 707 (1980) (enforcing a summons for an exemplar of the taxpayer's handwriting); *Donaldson* v. *United States*, 400 U.S. 517 (1971) (enforcing summons for employment applications, background data).[4] Hence, the appropriate test of relevance that is consistent with the statutory language is whether the documents requested "might have thrown light upon" the correctness of a return. See, e.g., *United States* v. *Arthur Young & Co.*, 677 F.2d 211, 218-219 (2d Cir. 1982), petition for cert. pending, No. 82-687; *United States* v. *Shlom*, 420 F.2d 263, 265 (2d Cir. 1969), cert. denied, 397 U.S. 1074 (1970); *Foster* v. *United States*, 265 F.2d 183, 187 (2d Cir.), cert. denied, 360 U.S. 912 (1959); *United States* v. *Noall*, *supra*, 587 F.2d at 125.

b. Contrary to petitioner's contention (Pet. 11-14), there is no conflict in the circuits on the question of the relevancy of tax pool analyses and similar documents to IRS investigations. As the decision below correctly noted (Pet. App. 12a) its holding that the tax pool analysis is relevant is in accord with a similar ruling of the Second Circuit in *United States* v. *Arthur Young & Co.*, 677 F.2d 211 (1982), petition for cert. pending, No. 82-687. As the court there concluded with respect to tax-accrual workpapers prepared by an independent auditor, "[d]ifferent tax positions lead to different amounts of liability. It is difficult to say that the assessment by the independent auditor of the correctness of

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[4]Accord: *United States* v. *Noall*, *supra*, 587 F.2d at 125 (internal audit data not used in preparation of returns); *United States* v. *Wyatt*, 637 F.2d 293, 300 (5th Cir. 1981) (evidence relating to illegal payments whether or not deducted on the returns); *United States* v. *Cleveland Trust Co.*, 474 F.2d 1234 (6th Cir.), cert. denied, 414 U.S. 866 (1973) (net worth statements submitted to bank with loan application); *United States* v. *McKay*, 372 F.2d 174 (5th Cir. 1967) (appraisal reports); *United States* v. *New York Telephone Co.*, 644 F.2d 953 (2d Cir. 1981); *United States* v. *Khalauf*, 49 A.F.T.R.2d (P.H.) para. 82-425 (N.D. Ind. 1982) (video tapes).

positions taken by the taxpayer in his return would not throw 'light upon' the correctness of his return" (677 F.2d at 219).

In support of its argument that there is a conflict as to the proper standard of relevancy (Pet. 12-13), petitioner cites *United States* v. *Matras*, 487 F.2d 1271 (8th Cir. 1973), and *United States* v. *Coopers & Lybrand*, 550 F.2d 615 (10th Cir. 1977). It reads those cases as "squarely" holding that material is not relevant if it is not used in the preparation of the tax return and if it contains opinion and not factual data with respect to actual transactions. But neither of those cases purports to establish a legal standard governing the relevance of summoned material. In those cases, the courts of appeals affirmed, as not clearly erroneous, factual determinations by the trial courts that a proposed corporate budget and a tax pool analysis, respectively, were not relevant to a tax investigation. However, both opinions emphasize the fact-bound nature of the determination of relevancy, and neither court suggested that in no circumstances could such documents be summoned. Indeed, in *Matras*, the court specifically recognized that "given the proper factual setting a court could find that budgets are potentially relevant to a tax investigation. Obviously, that issue must be determined on an ad hoc basis" (487 F.2d at 1274).

Coopers & Lybrand is to the same effect. There, the Tenth Circuit declined to enforce a summons for tax pool analyses on the ground of relevancy. But in so holding, the court quoted with approval the statement of the Eighth Circuit in *Matras* that such issues "must be decided on an ad hoc basis" (550 F.2d at 620). Thus, like the court in *Matras*, the Tenth Circuit in *Coopers & Lybrand* considered particularly persuasive the district court's finding that the summoned material was not relevant to the investigation. As the district court there appraised the record before it: "The

taxpayer-intervenor took the position, and presented evidence and testimony to the effect, that the data sought by the IRS to complete the audit and resolve these areas of concern did not appear in the Tax Pool. The Government did not seek to refute this contention, but then took the position that the Tax Pool might shed some light on other, yet unidentified, areas of tax liability" (413 F. Supp. at 942, 951). Given the state of the record in *Coopers & Lybrand*, the Tenth Circuit was reluctant to disturb the district court's finding of lack of relevancy.

Here, by contrast, the district court found (Pet. App. 46a) that "[t]he two summonses required the production of documents and other records which would very likely be relevant to making a correct determination" of petitioner's federal income and excise tax liabilities for the years under examination. It therefore concluded that "[p]roduction of the documents sought by the summonses in this case is necessary to the accomplishment of an effective examination * * *" (*id.* at 54a). In light of these markedly different findings, the court of appeals properly ruled that "[d]ocuments that focus and concentrate the Service's energy on questionable positions in the return, therefore, are highly relevant" (*id.* at 12a). Indeed, as the court further stated, "[i]t is, in fact, hard to imagine a document more likely to shed light on the correctness of those aspects of a return that harbor doubts than the tax pool analysis" (*ibid.*).

In these circumstances, the most that can be said with respect to the different results reached by *Matras* and *Coopers & Lybrand*, on the one hand, and the decision below and *Arthur Young & Co.*, on the other, is that based upon distinct factual records, four different district courts reached different results as to the relevancy of certain documents, and that these conclusions were affirmed by each of

the courts of appeals. These different results, however, do not constitute a conflict of decisions on a question of law that warrants resolution by this Court.

c. What is more, the standard of relevancy applied by the decision below — whether the records sought might throw light upon the correctness of the return — has been adopted by every court of appeals that has considered the issue, including the Eighth and Tenth Circuits subsequent to *Matras* and *Coopers & Lybrand*. See *United States* v. *Moon*, 616 F.2d 1043 (8th Cir. 1980); *United States* v. *City National Bank & Trust Co.*, 642 F.2d 388, 389 (10th Cir. 1981).

Finally, to the extent that *Matras* and *Coopers & Lybrand* suggest that only data used in the preparation of a tax return and which reflect actual financial transactions are relevant to a tax investigation, that aspect of those decisions has not only been eroded by subsequent decisions of this Court and other courts of appeals (see pages 8-9, *supra*), but by subsequent decisions of the Eighth and Tenth Circuits themselves. *United States* v. *Norcutt*, 680 F.2d 54 (8th Cir. 1982); *United States* v. *Southwestern Bank & Trust Co.*, 683 F.2d 994 (10th Cir. 1982).[5] Hence, there is no conflict on the question of the proper legal standard of relevancy under 26 U.S.C. 7602.

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[5]Every court that has considered petitioner's interpretation of *Coopers & Lybrand* has rejected it. See *United States* v. *Noall*, *supra*, 587 F.2d at 127; *United States* v. *Arthur Young*, *supra*; *United States* v. *Arthur Andersen & Co.*, 474 F. Supp. 322 (D. Mass. 1979), appeal dismissed as moot as to one party, 623 F.2d 725 (1st Cir.), aff'd on other grounds, 625 F.2d 725 (1st Cir. 1980); *United States* v. *Riley Co.*, 45 A.F.T.R.2d (P.H.) para. 80-551 (N.D. Ill. 1980); *In re Grand Jury Subpoena Duces Tecum (Charles Rice)*, 483 F. Supp. 1085 (D. Minn. 1979); *United States* v. *First Chicago Corp. & Affiliated Corps.*, 43 A.F.T.R.2d (P.H.) para. 79-426 (N.D. Ill. 1978).

2. *Privilege.* Petitioner also seeks review of the decision below that its tax pool analysis is not privileged from disclosure in response to an internal revenue summons. It urges (Pet. 14-16) that the decision here conflicts with *United States* v. *Arthur Young & Co.*, 677 F.2d 211 (2d Cir. 1982), petition for cert. pending, No. 82-687. There, the court refused to enforce a summons directing a certified public accountant to produce tax accrual workpapers prepared in connection with regular financial audits of a publicly held corporation and its certification of the corporation's financial statements to comply with the securities laws. The court rested its decision on the ground of a work-product privilege, although the opinion is couched in the rationale of the accountant-client privilege. As the court saw the matter, "[t]he verification procedure envisioned by the [Securities] Act requires, in turn, that management feel free to cooperate with their auditors, and to disclose to them confidential information, such as the questionable positions taken on tax returns * * *" (677 F.2d at 219). Hence, the court concluded "that the countervailing policies at issue in the case * * * require[d it] to fashion protection for the work that independent auditors, retained by publicly owned companies to comply with the federal securities laws, put into preparation of tax accrual workpapers" (*ibid.*).

While the tax pool analysis at issue here was generated by petitioner's employees in its tax department, rather than by an outside independent auditor as in *Arthur Young & Co.*, the cases are concededly in conflict as to whether such documents — containing an assessment of the questionable items on the return — are privileged from disclosure. Here, the court below enforced an internal revenue summons for the identical category of documents prepared by petitioner's in-house accountants and revealed to its independent accountant as part of the selfsame process of establishing a

reserve for contingent tax liabilities and certifying its financial statements. In so holding, the court below relied upon this Court's admonition in *Couch* v. *United States*, 409 U.S. 322, 335 (1973) that "no confidential accountant-client privilege exists under federal law, and no state-created privilege has been recognized in federal cases * * *." Hence, the court thereby rejected "[t]he logic of *Arthur Young* [that] implies that the taxpayer's revelation of tax accrual workpapers to an accountant should be considered a communication in confidence" (Pet. App. 19a; footnote omitted).

Moreover, the decision below also conflicts with *Arthur Young & Co.* on the question whether such documents constitute privileged work product. Here, the court declined to classify such documents as work product because they were not prepared by attorneys in anticipation of litigation. As the court stated, "the tax pool analysis carries much more the aura of daily business than it does of courtroom combat. We hold, therefore, that the tax pool analysis and backup memoranda are not protected work product materials" (Pet. App. 25a).

Since the second question presented in the petition — whether such documents are privileged from disclosure under an accountant-client or work product privilege — is already before the Court in the petition in *Arthur Young & Co.*, we believe that it would be appropriate for the Court to hold this case to await the disposition of *Arthur Young & Co.*[6]

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[6]Petitioner also seeks to cloak its tax pool analysis under the protection of the attorney-client privilege (see Pet. 16-17). But the court of appeals ruled that petitioner waived any privilege when its employees discussed many of the issues in the tax pool analysis with its independent auditors (Pet. App. 17a). While petitioner alleges (Pet. 16-17) that there is a conflict in the circuits as to the circumstances in which a waiver of the attorney-client privilege occurs, that argument is predicated on the assumption that the attorney-client privilege is applicable in the first

CONCLUSION

The Court should hold this case to await the ultimate disposition of *United States* v. *Arthur Young & Co.*, No. 82-687, with respect to the second question presented (whether tax accrual workpapers are privileged from disclosure).[7]

Respectfully submitted.

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instance. Both courts below, however, held that petitioner's failure to prove which documents were prepared by attorneys "considerably undermines its claim to the attorney-client privilege" (Pet. App. 21a) and that petitioner's blanket assertion of the privilege was insufficient (*id.* at 20a). See also *id.* at 56a. There is, accordingly, no occasion to consider the waiver question in this case where there are two independent bases for the court's conclusion that the attorney-client privilege is not applicable.

[7]We are serving a copy of this brief upon counsel for the respondents in *United States* v. *Arthur Young & Co.*, No. 82-687.

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No. 82-716

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

THE EL PASO COMPANY,
Petitioner,
v.
UNITED STATES OF AMERICA, *et. al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

REPLY BRIEF

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REPLY BRIEF

I. THE COURT SHOULD HEAR THIS CASE ON THE MERITS.

A. This Case Presents the Full Range of Issues on the Tax Pool Analysis Question.

The issues of law and public policy raised by this case are of deep and immediate concern to all public companies subject to the financial reporting requirements of the securities laws. The United States has conceded in its brief that the tax pool analysis issue should be considered by this Court. Brief for the United States (hereinafter "Brief") at 13-14. The nine amicus curiae briefs filed

with the Court [1] by organizations with a combined membership of over a quarter million businesses, associations, and professionals further emphasize the importance and urgency of the questions posed by this case. We submit that there is a pressing need to resolve the conflict and confusion in the circuits regarding the tax pool analysis question, that the issues have crystallized and are ready for review, and that this case presents the overall question in the best posture for a complete resolution of all the issues involved.

Despite the clear need for a complete resolution of this question, the United States urges this Court to consider only half the problem. It argues that the Court should review the question whether tax pool analyses are privileged, but deny review on the parallel, and logically anterior, question of whether tax pool analyses are relevant under 26 U.S.C. § 7602, the statute granting the IRS summons authority. This approach would seriously handicap the Court in its consideration of the entire issue, since the relevance and privilege questions are closely interrelated.

No court which has considered the tax pool analysis issue has done so without addressing the relevance question,[2] nor should this Court. If the Court were to con-

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[1] Amicus curiae briefs urging the Court to grant certiorari in this case have been filed by: The American Gas Association; The American Petroleum Institute; The Chamber of Commerce of the United States; The Chemical Manufacturers' Association; The Interstate Natural Gas Association; Main Hurdman; The National Association of Manufacturers; The National Coal Association; and Tax Executives Institute, Inc.

[2] United States v. Arthur Young & Co., 496 F. Supp. 1152, 1156, *aff'd & rev'd*, 677 F.2d 211, 218-19 (2d Cir. 1982), *petition for cert. filed*, 51 U.S.L.W. 3341 (U.S. Oct. 20, 1982) (No. 82-687); United States v. The El Paso Co., Appendix to Petition for a Writ of Certiorari (App.) 11a-12a; United States v. Arthur Andersen & Co., 474 F. Supp. 322, 329-330 (D. Mass. 1979), *aff'd*, 623 F.2d 725, 729 (1st Cir. 1980); United States v. Coopers & Lybrand, 413

sider the relevance question and were to conclude that tax pool analyses are not relevant within the meaning of Section 7602, as the Tenth Circuit did in *United States* v. *Coopers & Lybrand*, 550 F.2d 615 (1977), it would be unnecessary to reach the privilege question. Moreover, if the Court failed to consider the relevance question and concluded that tax pool analyses are not privileged, the overall question of their amenability to IRS summonses would remain unresolved, since the question would surely arise again on the relevance issue. Thus, the approach the United States urges would, at minimum, hamper the Court's full consideration of this important issue and, at worst, constitute a waste of judicial resources and prolong uncertainty in the circuits.

B. This Case Presents the Issues as They Are Most Likely to Recur.

The United States requests the Court to hold this case pending ultimate disposition of *United States* v. *Arthur Young & Co.*, No. 82-687. However, we respectfully suggest that if one case or the other is to be held, the instant case should be decided and *Arthur Young* held. This is because the instant case presents the full range of issues likely to arise in a tax pool analysis summons case, including the relevance, work-product privilege and attorney-client privilege issues, whereas the Government has sought certiorari in *Arthur Young* only on the work-product privilege issue alone.[8]

F. Supp. 942, 946 *et seq.* (D. Colo. 1975), *aff'd*, 550 F.2d 615, 618-621 (10th Cir. 1977).

The First Circuit in *Arthur Andersen* found that the relevance issue was so significant to a resolution of the tax pool analysis question that it refused to consider it on the unsatisfactory record presented to it. 623 F.2d at 729. The instant case presents the tax pool analysis issue in a straightforward form, and provides a perfect matrix for a decision on this important issue.

[8] The cross-petition in *Arthur Young* focuses on important related issues, but not in the specific areas the courts have had the most difficulty resolving.

Moreover, this case presents the issues in the context in which they are most likely to recur. In *Arthur Young*, as in *Coopers & Lybrand*, the IRS summoned the tax pool analysis from the taxpayer's independent accountant, whereas in this case the tax pool analysis was prepared and retained in-house and was summoned from El Paso by the IRS. It is now clear that the majority of future IRS summonses for tax pool analyses will be directed to taxpayers rather than their independent accountants. This is because, subsequent to both the *Arthur Young* and *Coopers & Lybrand* decisions, the IRS announced a revision in its guidelines for revenue agents, requiring them to summon tax pool analyses from the taxpayer, rather than from its independent auditor, whenever possible. I Internal Revenue Manual (Audit) (CCH) § 4024.4(5) (1981).

While this shift in focus fails to resolve the problem, it does assure that this issue will occur most frequently in the future in the context of summonses issued to taxpayers rather than their independent accountants. Accordingly, if the Court wishes to address the issue in the context in which it is most likely to recur, it should consider this case on the merits and hold *Arthur Young* to await the ultimate disposition of this case. We continue to feel, however, that in view of the importance of the issues and the likelihood of their recurrence, the Court would be best served by hearing both cases.

II. RESPONSES TO SPECIFIC POINTS IN THE UNITED STATES' BRIEF.

A. There Is a Conflict in the Circuits Concerning the Applicable Standard of Relevance.

In the face of overwhelming authority to the contrary, the United States argues in its Brief that there is no conflict in the circuits on the question of the relevance of tax pool analyses to IRS investigations. Brief at 9. Its thesis is that neither *Cooper & Lybrand* nor *Matras* purports

to establish a legal standard governing the relevance of summoned material. Rather, it says, these cases involve mere "factual determinations." *Id.* at 10.

This argument is directly contradicted by the Second Circuit in *Arthur Young*, which expressly refused to accept the standard of relevance articulated in *Coopers & Lybrand* and *Matras*[4]. 677 F.2d at 218. The court thus recognized that *Coopers & Lybrand* and *Matras* had established a legal standard governing relevance, but disagreed with it. *Accord, United States* v. *Noall*, 587 F.2d 123, 126-127 (2d Cir. 1978), *cert. denied*, 441 U.S. 923 (1979); *Arthur Young, supra*, 496 F. Supp. at 1156. The court made no suggestion that either *Coopers & Lybrand* or *Matras* is confined to its facts, nor did the Fifth Circuit do so in this case. App. 11a-12a, 42a.

Moreover, the commentators on this question universally take the view that *Coopers & Lybrand* articulated a legal standard of relevance.[5] *E.g.*, Caplin, *Government*

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[4] United States v. Matras, 487 F.2d 1271 (8th Cir. 1973).

[5] In addition to the courts and commentators, a group convened by the Justice Department Tax Division itself has concluded not only that *Coopers & Lybrand* establishes a legal standard of relevance to be applied on a case-by-case basis, but that *Coopers & Lybrand* was correctly decided. Justice Department Tax Division's Advisory Group, *Report of the Committee on Standards for Seeking Accountants' Tax Accrual Workpapers* (May 1980). The Report stated:

> The members of the Committee agree with the decision in *Coopers*. All of the members of the Committee believe that if the I.R.S. were to prevail in such a situation there would be no effective restraint against a "fishing expedition" by the I.R.S. Indeed, the logical extension of the I.R.S.'s position in *Coopers* would be to require independent auditors who prepare tax accrual workpapers to disclose the taxpayer's "questionable positions." [Report at 4-5.]

The Committee unanimously disapproved the IRS's position in *Coopers & Lybrand* and recommended that the Tax Division adopt

Access to Independent Accountants' Tax Accrual Workpapers, 1 Va. Tax Rev. 57, 74, 80 (*Coopers & Lybrand* establishes a "variable relevance standard" with which the lower court decision on relevance in *Arthur Young* was in direct conflict); Robinson and Stoltenberg, *Privilege and Accountants' Workpapers*, 68 ABA Journal 1248, 1249-1250 (1982) (*Arthur Young* and *Coopers & Lybrand* in conflict over standard of relevance).

As the commentators observe, *Coopers & Lybrand* establishes the legal framework within which the facts of different cases may be analyzed. Its test is a balancing test which articulates several factors to be considered in weighing the facts of each case.[6] *Arthur Young*, the decision below in this case, and *Noall* disagreed with this standard, arguing that a much more sweeping construction of relevance was appropriate. Thus, there is a conflict on the question of which legal standard of relevance, the stricter or the more liberal, should apply. To emphasize, as the Government does, that before a determination can be made the chosen legal standard must be ap-

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the following standard, adapted from *Coopers & Lybrand*, in determining when to bring a summons enforcement action:

> The Justice Department's Tax Division will generally bring an enforcement action for tax accrual workpapers where there is a reasonable belief that the workpapers would disclose facts or circumstances relating to a particular transaction or transactions where such facts or circumstances are not otherwise available or apparent through normal audit procedure.

This Committee thus clearly recognized that *Coopers & Lybrand* does establish a legal standard of relevance. It is significant, however, that the IRS declined to follow the Committee's recommendation, thus forcing the issue that is now before the Court.

[6] These factors, set out in the District Court opinion, 413 F. Supp. 942, 949-954 (D. Colo. 1975), include such considerations as: whether the information sought consists of opinions and theories, not facts; whether the information sought was prepared in connection with the tax return; whether the IRS has a realistic expectation rather than an idle hope that something might be discovered; and others. *See* El Paso's Petition for a Writ of Certiorari at 12.

plied to the facts of each case is to do no more than state the obvious. The fact that there is a conflict in the circuits over the proper legal standard of relevance is not diminished because the test is a balancing test rather than a *per se* test. The Government's argument simply does not withstand scrutiny.

B. The Government Mischaracterizes the Relevance Issue.

Once it is recognized that *Coopers & Lybrand* presents a balancing test, it is apparent that no one of the factors articulated by *Coopers & Lybrand* need be determinative. For example, one factor *Coopers & Lybrand* identifies is whether the documents summoned were prepared in connection with the taxpayer's tax return. 413 F. Supp. at 950. Standing alone, the fact that the documents were not prepared in connection with the tax return may not be sufficient to support a ruling that the documents were not relevant to the IRS inquiry, although it undoubtedly would contribute to the balance against a finding of relevance.

Apparently misunderstanding this, the Government completely mischaracterizes El Paso's analysis of the relevance issue. Brief at 7-9 and 12 n.5. According to the Government, El Paso contends that because its tax pool analysis was not prepared in connection with its tax return, therefore it necessarily is not relevant. Nowhere in El Paso's Petition does it advance such an argument. Whether the information sought was prepared in connection with a return is only *one factor* to be considered in the overall balancing test established by *Coopers & Lybrand* and advanced by El Paso in this case (Petition for a Writ of Certiorari at 12), but neither El Paso nor the Tenth Circuit has argued that it is necessarily dispositive.

C. *Coopers & Lybrand* and *Matras* Have Not Been Overruled.

On page 12 of its Brief, the Government suggests that *Coopers & Lybrand* and *Matras* are no longer persuasive because a more liberal standard of relevance has subsequently been adopted by the Tenth and Eighth Circuits. One of the cases cited for this proposition appears to have no bearing on the issue at all. *United States* v. *Moon*, 616 F.2d 1043 (8th Cir. 1980). The other cites *Matras* as *authority* for its conclusion and fails to discuss *Coopers & Lybrand* at all. *United States* v. *City National Bank & Trust Co.*, 642 F.2d 388, 389 (10th Cir. 1981).

In *Moon*, the Eighth Circuit discussed neither *Matras* nor the "might throw light upon" standard. *City National Bank*, in the Tenth Circuit, involved a summons only for factual records. The IRS in that case sought bank deposit slips and similar records in an attempt to establish that payroll checks payable to taxpayers had been diverted to the bank account in question. These were factual records having a direct bearing on the tax liability shown on taxpayer's return, and the *Coopers & Lybrand* court would have agreed that the relevance requirement had been met. *See Coopers & Lybrand*, *supra*, 413 F. Supp. at 950; Caplin, *supra*, 1 Va. Tax Rev. at 65, 67, 74.

D. The Attorney-Client Privilege.

Although it concedes that the accountant work-product privilege argument is an important one which should be heard by the Court, the Government attempts in a footnote to dismiss El Paso's attorney-client privilege argument as unworthy of the Court's consideration. Brief at 14 n.6. Its first argument for this position is that the Fifth Circuit ruled that El Paso waived the privilege when it disclosed parts of the tax pool analysis to its independent auditors. But this is an argument *for* considering the attorney-client privilege question, since the

Fifth Circuit's waiver theory is directly contradictory to the Second Circuit's accountant work-product privilege. If a tax pool analysis is privileged in the hands of the taxpayer's independent accountant, as *Arthur Young* holds, then, as the Fifth Circuit itself recognized, "the taxpayer's revelation of tax accrual workpapers to an accountant should be considered a communication in confidence." App. 19a (footnote omitted).

The second argument, that El Paso failed to make a sufficiently specific assertion of the attorney-client privilege, is undercut by the fact that the Fifth Circuit found the language of the IRS summons, later incorporated in the District Court judgment, so unclear that it struck half of it. App. 8a-9a. El Paso asserted the attorney-client privilege at the very outset of these proceedings and has contended throughout that the imprecision of the summons concerning the material covered prevented an itemized assertion of the privilege. The Fifth Circuit's conclusion that much of the language of the summons was unclear in meaning underscores El Paso's dilemma—how to make a more specific assertion of privilege when it is unclear what documents have been summoned.

Under the circumstances, El Paso made the most specific assertion of the attorney-client privilege possible. The Government's failure to draft its summons more clearly should not foreclose El Paso from claiming the privilege.

CONCLUSION

This Court should grant certiorari on both questions presented in El Paso's Petition for a Writ of Certiorari and should consider the case on its merits.

Respectfully submitted,

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STATEMENT PURSUANT TO SUPREME
COURT RULE 28.1

Petitioner, The El Paso Company, reports, pursuant to Rule 28.1 of the Rules of this Court, that its listing of parent companies, subsidiaries (except wholly owned subsidiaries), and affiliates on page ii of its Petition for a Writ of Certiorari in this case should be amended to eliminate the Geonuclear Nobel Paso Company and the La Salle Terminal Company, both of which have been dissolved. Additionally, The El Paso Company notes that there currently is a tender offer outstanding for a substiantial portion of The El Paso Company's common stock. This offer by R. H. Holdings Corporation, a wholly-owned subsidiary of Burlington Northern Inc., is unopposed by The El Paso Company's board of directors. The offer expires February 7, 1983, unless extended.

The El Paso Company will make a further filing with this Court pursuant to Rule 28.1 at such time as its relationship with R. H. Holdings Corporation and Burlington Northern Inc. is clarified.

E. Barrett Prettyman, Jr.

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UNITED STATES OF AMERICA, *ET AL.*,

Respondents.

BRIEF OF AMERICAN GAS ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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Respondents.

BRIEF OF AMERICAN GAS ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

The American Gas Association (A.G.A.) submits this brief *amicus curiae* in support of the petition for a writ of certiorari filed by The El Paso Company. The A.G.A. supports this Court's review of all of the issues presented by the petition.[1]

INTEREST OF THE *AMICUS CURIAE*

The A.G.A. is a trade association representing the interests of its approximately 250 member companies involved in the distribution and transmission of natural gas throughout the

[1] Written permission from the parties to this litigation to file this brief as *amicus curiae* has been obtained and has been filed with the Clerk of this Court.

50 states. The El Paso Company, the petitioner in this case, is a holding company of several corporations, one of which, The El Paso Natural Gas Company, is a member of the A.G.A.

A divided panel of the United States Court of Appeals for the Fifth Circuit in this case affirmed the judgment of the United States District Court enforcing an Internal Revenue Service summons issued to The El Paso Company. The court held, in pertinent part, that: (1) the taxpayer's tax pool analysis and supporting memoranda summoned by the Service were "relevant," within the meaning of 26 U.S.C. §7602, to determining the correctness of certain of El Paso's tax returns, (2) the tax pool analysis and supporting memoranda were protected neither by the attorney-client privilege nor by the work-product doctrine, and (3) the public policies reflected in federal securities laws did not require denial of enforcement of the summons.

The Fifth Circuit's decision is of vital importance to, and will directly affect, all publicly held corporations. The vast majority of A.G.A. member companies, like The El Paso Company, are publicly held. Because of the unusual and widespread importance of the issues decided by the Fifth Circuit, the A.G.A. is filing this *amicus curiae* brief in support of The El Paso Company's petition.

ARGUMENT

The petition for writ of certiorari filed by The El Paso Company presents genuinely important issues requiring this Court's resolution. The issues are central to the fair and consistent enforcement of both the revenue and securities laws, the implementation of financial disclosure requirements, and the interpretation of the attorney-client and accountant-client relationships. The Fifth Circuit has held that it is lawful to require a public corporate taxpayer to provide the Internal Revenue Service with the corporation's own "tax pool analysis". The tax pool analysis reflects the taxpayer's estimate of ultimate tax liability for a taxable year. It includes the identification of issues which might be subject to challenge

by the Internal Revenue Service, discussion of the merits of those issues, and estimated dollar amounts at which the company would settle disputed positions at the administrative level of the Service. The tax pool analysis is developed by the taxpayer alone or with the assistance of independent auditors.

Through its decision, the Fifth Circuit has erroneously construed 26 U.S.C. §7602 as embodying a Congressional judgment that society's interest in the collection of revenues takes priority over other interests of substantial magnitude and having long-standing recognition – namely, the need for full and candid corporate financial disclosure and the need to preserve attorney-client confidences. This Court's review is required because the Courts of Appeals are now irreconcilably divided over the extent to which the statutory responsibilities of the Internal Revenue Service must override these other important interests.[2]

I. THIS CASE PRESENTS AN IMPORTANT QUESTION ON HOW TO RESOLVE THE EXISTING CONFLICT BETWEEN FEDERAL REVENUE COLLECTIONS AND FEDERAL SECURITIES REQUIREMENTS

A clear conflict between federal revenue collections and the maintenance of a fair and informed securities market has been engendered by the Internal Revenue Service's summoning of tax pool analyses.[3] Tax pool analyses are used by corporations in fulfilling the requirement of the securities laws that public companies periodically file audited financial statements disclosing material and contingent tax liabilities. See, *e.g.*, 15 U.S.C. §78*l*. Complete candor in the preparation of such analyses is necessary to implement properly the policy of full financial disclosure inherent in the federal securities laws.[4]

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[2] See Petition for a Writ of Certiorari at 10 for a complete and concise summary of the issues on which, and the judgments by which, the Courts of Appeals are split.

[3] *Id.* at 18-21.

[4] See comments of current Internal Revenue Commissioner Roscoe Egger and former Commissioner Mortimer Caplin, Petition at 20.

To say that the Fifth Circuit's decision may discourage maximum disclosure of contingent tax liabilities is not, as the majority below incorrectly believed, to "assum[e] that corporations will dishonor their legal obligations" or "[e]vade their responsibilities under the securities laws. . . ." Pet. App. 27a. This is not an all-or-nothing issue. A corporate taxpayer may fulfill its legal obligations with respect to a tax pool analysis within a broad zone of reasonableness. While there is no reason to believe that corporations will disregard those obligations, the decision below may well provide a disincentive for companies to make maximum disclosure within the permissible range, since that may risk exposing to the Internal Revenue Service more tax analyses than is necessary.

Insofar as the effective operation of the securities markets envisioned in passage of the securities laws is hampered by specific techniques of revenue collection, such as the Service's use of the summons, this Court's review of such techniques is necessary.

II. THIS CASE DIRECTLY CONFLICTS WITH THE HOLDING OF THE SECOND CIRCUIT IN *ARTHUR YOUNG & CO.*

The Second Circuit's recent recognition of privileged status for an accountant's tax pool analysis in *United States* v. *Arthur Young & Co.*, 677 F.2d 211 (1982), *petition for cert. filed*, No. 82-687 (Oct. 20, 1982), is in direct conflict with the Fifth Circuit's decision. The Fifth Circuit inexplicably read the *Young* privilege as existing only when the document concerned is in the possession of independent auditors. Pet. App. 12a, n.7. If the tax pool analysis privilege exists, there is no valid reason for making its effectiveness contingent upon physical possession by an outside auditor. Indeed, the traditional treatment of privilege suggests the opposite. It would be anomalous if the Service could not obtain a tax pool analysis from a taxpayer's outside auditors but could obtain the same analysis from the taxpayer itself. That anomaly would undoubtedly lead to a proliferation of litigation in other circuits absent a decision by this Court.

The existence of the accountant work-product privilege established by the Second Circuit, and its applicability to situations where the Service seeks discovery directly from the taxpayer, both matters of inter-circuit conflict, are therefore questions meriting this Court's review.

III. THIS CASE PRESENTS A FUNDAMENTAL AND VITAL QUESTION OF FEDERAL STATUTORY CONSTRUCTION INVOLVING THE TYPE OF INFORMATION THAT MAY BE SUMMONED AS RELEVANT TO THE DETERMINATION OF TAX LIABILITY

Consideration of the Fifth Circuit's decision involving the relevance of The El Paso Company's tax pool analysis should properly begin with construction of the statute itself. Title 26 U.S.C. §7602 authorizes examination of "any books, papers, records, or other data which may be relevant" to determining the correctness of the tax return involved. The Fifth Circuit's majority found it difficult "to imagine a document more likely to shed light on the correctness of those aspects of a return that harbor doubts than the tax pool analysis." Pet. App. 12a. That view is founded, however, on the majority's notion that "[d]ocuments that focus and concentrate the Service's energy on questionable positions in the return . . . are highly relevant." *Id.*

The majority's analysis, which conflicts with that of the Tenth Circuit in *United States* v. *Coopers & Lybrand*, 550 F.2d 615 (10th Cir. 1977), erroneously ignores the critical distinction, articulated in Judge Garwood's incisive dissent, between documents that contain "*factual* information" respecting a taxpayer's tax liability or the correctness of its return, and documents that would merely "facilitat[e] or mak[e] more efficient the process of examination." Pet. App. 33a, 32a. As Judge Garwood's dissenting opinion persuasively demonstrates, there is substantial reason to believe that 26 U.S.C. §7602 authorizes the discovery of factual

information but not of the taxpayer's post-return private thought processes, theories, and opinions.[5]

There is little question that the Internal Revenue Service is entitled to all information and data necessary to determine the correctness of the taxpayer's return. Without such information, the Service cannot properly perform its responsibilities. On the other hand, it is difficult to believe that Congress intended to go so far as to give the Service access to the professional judgments of tax lawyers and accountants, which are paid for by the taxpayer, and which form an integral part of many tax pool analyses. Since the beginning of our revenue laws, this type of information has never been regarded as necessary to establish the correctness of a taxpayer's liability, and the Service's mission has not suffered without it. Nor should this type of information be necessary in the future. A tax pool analysis is not "relevant" as the term is used in 26 U.S.C. §7602, because it is not needed to determine the correctness of liability on the tax return.

The resolution of the split among the Courts of Appeals regarding the appropriate construction of 26 U.S.C. §7602 is available only through this Court's review.

IV. THIS CASE RAISES IMPORTANT QUESTIONS CONCERNING THE APPLICATION OF THE ATTORNEY-CLIENT PRIVILEGE

As recognized by the Fifth Circuit, in order to comply with the securities laws, companies such as El Paso must "prepare in-house, or have prepared by outside auditors, an analysis of their contingent tax liabilities." Pet. App. 5a. In El Paso's case, the tax pool analysis containing its contingent tax liabilities was prepared at the direction of and in consultation with their in-house lawyers. The Fifth Circuit held that El Paso's

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[5] Judge Garwood points out that former Internal Revenue Commissioner Mortimer Caplin has observed that after reflection on the word "data" as contained in section 7602(a), "[w]hat comes to mind in the use of that term are items such as books, records, and other factual materials – not opinions, projections, conjectures and other thought processes." Pet. App. 35a.

discussions of limited portions of the tax pool analysis with its outside auditors destroys both any expectation of confidentiality regarding the entire contents of the analysis and any right to claim attorney-client privilege. To interpret the federal securities laws as imposing responsibilities which, when diligently carried out, destroy the oldest of the privileges for confidential communications known to the common law is a matter of most serious consequence which should be reviewed by this Court.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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No. 82-716

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

THE EL PASO COMPANY,
Petitioner,

v.

UNITED STATES OF AMERICA, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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BRIEF *AMICUS CURIAE* OF THE AMERICAN PETROLEUM INSTITUTE IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

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BRIEF *AMICUS CURIAE* OF THE AMERICAN PETROLEUM INSTITUTE IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

The American Petroleum Institute ("API") submits this brief *amicus curiae* in support of the petition for writ of certiorari filed by The El Paso Company.[1] API supports this Court's review of both questions presented by the petition; *viz.*,

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[1] Petitioner and respondent have given their written consent to the filing of this brief *amicus curiae*. Copies of those consents have been lodged with the clerk.

whether the court below erred in holding, contrary to decisions of other Circuit Courts, that a company's "tax pool analysis" is relevant under 26 U.S.C. § 7602 to an Internal Revenue Service investigation of the company's tax returns, even though the analysis was not used in preparing the returns, consists exclusively of speculation and opinion concerning potential tax issues, negotiations, and litigation the company may face, and was developed for purposes of assessing and reporting the company's contingent tax liability as required by the federal securities laws; and

whether the court below erred in holding, contrary to decisions in other Circuit Courts, that a company's tax pool analysis and its discussions relating thereto are not privileged, under either the attorney-client privilege or a work-product doctrine, even though the analysis was prepared by and in consultation with the company's attorneys and was confidentially discussed with its independent auditors for purposes of complying with the securities laws.

INTEREST OF THE AMICUS CURIAE

The American Petroleum Institute ("API") is a trade association consisting of approximately 330 member corporations and 8,000 individual members. API's members are engaged in all facets of the petroleum industry, including the production, refining, and marketing of crude oil and refined petroleum products.

The vital interest of API in this case is that of taxpayers who are or could be similarly situated to the petitioner in this case. Member corporations include publicly held corporations or subsidiaries of publicly held corporations subject to federal securities laws. Members of the API are subject to jurisdiction in each of the circuits of the courts of appeal which have rendered inconsistent decisions regarding the scope of 26 U.S.C. § 7602 and this Court's decision in *United States v. Powell*, 379 U.S. 48 (1964). In this case the Internal Revenue Service

("IRS") sought to enforce a summons seeking production of what is often referred to as tax pool analysis, non-current tax account, or tax accrual workpapers.

The divided court of appeals held that in this case, a routine investigation not involving an allegation or suspicion of fraud, the IRS may compel, through a summons enforcement proceeding, production of "tax pool analysis" and any memoranda used to prepare the analysis. *United States v. El Paso Co.*, 682 F.2d 530, 545 (5th Cir. 1982). In so doing, the court of appeals held, contrary to the Tenth Circuit's decision in *United States v. Coopers & Lybrand*, 550 F.2d 615 (10th Cir. 1977), that the tax pool analysis and supporting memoranda, although not used in the preparation of a return and containing opinions, forecasts and judgments of the taxpayer made pursuant to requirements of the federal securities laws, were "relevant" within the meaning of 26 U.S.C. § 7602. *El Paso*, 682 F.2d at 537-38. Further, the court of appeals held that the tax pool analysis was not privileged under either the attorney-client privilege or work product doctrine, thereby again producing a conflict with other courts of appeals. *Id.* at 542.

In addition to being subject to inconsistent views of several courts of appeal, the subject of petitioner's writ of certiorari in this case raises important questions of the administration of federal tax and securities laws as well as the continued vitality of this Courts' opinion in *Upjohn Co. v. United States*, 449 U.S. 383 (1981).

REASONS FOR GRANTING THE WRIT

A decision to grant the petition for certiorari in this case will resolve conflicts existing in the courts of appeal and provide guidance to taxpayers consistent with this Court's construction of 26 U.S.C. § 7602 in *United States v. Powell*, 379 U.S. 48 (1964). It will enable this Court to prevent the erosion of its decision in *Upjohn Co. v. United States*, 449 U.S. 383 (1981). It will allow this

Court to reaffirm the congressional policy underlying the federal securities laws and avoid undue interference with that policy by administrative interpretations of the internal revenue laws in the absence of congressional intent to do so and, inferentially, in the face of much more limited and precise action by Congress.

I. RELEVANCE

Public companies subject to the federal securities laws must file financial statements that have been examined in accordance with generally accepted auditing standards. *See* 15 U.S.C. § 81(l) and (m), Regulation S-X, 17 C.F.R. § 210.1-.12-29 (1981). Companies subject to the federal securities laws must prepare or have prepared by their independent public auditors an analysis of their contingent tax liabilities in order to comply with the federal securities laws.

Whether prepared by the taxpayer or its independent public auditors, the positions taken by a taxpayer on its return are discussed with the independent public auditor. These confidential discussions, which are incident to the work resulting in the estimation of a taxpayer's potential exposure, are indispensable to the independent audit process. The independent audit process is designed to insure that the taxpayer's financial statements meet the required federal securities laws standards. In this process, potential results are often explored on a hypothetical worst-case basis. The memoranda supporting the tax pool analysis reflect the mental processes of the taxpayer. They often analyze potential results of transactions based on current or possible case law and legislation as well as current and possible IRS positions or reactions. The taxpayer's inquiry is not limited to positions taken with respect to a federal tax return. Many corporations consider items of significant exposure in the other jurisdictions, including foreign jurisdictions. *Cf. United States v. Coopers & Lybrand*, 413 F. Supp. 942, 951 (D. Col.

1975). The resulting tax pool analysis or tax accrual workpapers "contain the taxpayer's evaluation of its exposure to liability for additional income taxes; they pinpoint the precise tax issues of concern to the taxpayer—issues which may be vulnerable to IRS attack; and they reflect, on an item-by-item basis, the taxpayer's careful estimate of its likelihood of prevailing in the event of controversy. In short, they provide the IRS examining officer with a definitive roadmap to the soft spots in the tax return." Caplin, *IRS Toughens Its Stance on Summoning Accountants' Tax Accrual Workpapers*, 53 J. Tax. 130, 130 (1980).

In *El Paso*, the court below refused to hold that the analyses in question were not the proper subject of a summons within the scope of 26 U.S.C. § 7602. 682 F.2d at 537. The standard used by the Fifth Circuit in determining that the analyses in question may be relevant in ascertaining the correctness of the taxpayer's return was "whether the summons seeks information which "might throw light upon the correctness of the taxpayer's return,"," *Id.* (citing *United States v. Wyatt*, 637 F.2d 293, 300 (5th Cir. 1981) and *United States v. Noall*, 587 F.2d 123, 125 (2d Cir. 1978), *cert. denied*, 441 U.S. 923 (1979)).

A similar view was expressed by the Second Circuit, in the case of *United States v. Arthur Young & Co.*, 677 F.2d 211, 218 (2d Cir. 1982), *petition for cert. filed*, 51 U.S.L.W. 3341 (Oct. 20, 1982) (No. 82-687), which denied enforcement of a summons issued to an independent public accounting firm on other grounds, discussed below. The Solicitor General filed a petition for writ of certiorari in *United States v. Arthur Young*, 677 F.2d 211 (2d Cir. 1982), *petition for cert. filed*, 51 U.S.L.W. 3341 (October 20, 1982) (No. 82-687).

The holdings of the Fifth and Second Circuits are in direct conflict with the holding in the Tenth Circuit in *United States v. Coopers & Lybrand Co.*, 550 F.2d 615

(10th Cir. 1977). There the IRS sought to compel production of a tax pool analysis held by the independent public auditor and not the taxpayer. *Id.* at 617. There, as in this case, it was uncontested that the independent public auditor had no responsibility for the preparation or review of the taxpayer's income tax returns and that the tax pool analysis was not prepared in connection with the preparation and filing of the taxpayer's return. *Id.* There the taxpayer created a tax pool analysis file for its use in preparing its annual consolidated financial statements and it was utilized by the independent public auditor in verifying, in accordance with federal securities laws, that the financial statements complied with generally accepted accounting principles. *Id.* at 618. There, as here, the IRS did " 'not seek records of corporate transactions or the data which are customarily maintained in support of company transactions, instead it seeks private thoughts and theories of the taxpayer.' " *Id.* Although recognizing the broad investigative powers conferred on the IRS by 26 U.S.C. § 7602, the court noted that such powers are not without limitation and held that the summons issued by the IRS was unenforceable. 550 F.2d at 619, 621.

The holdings of the Fifth and Second Circuits are also in conflict with the Eighth Circuit's decision in *United States v. Matras*, 487 F.2d 1271 (8th Cir. 1973). In that case, cited by this Court in *United States v. Bisceglia*, 420 U.S. 141 (1975), as an appropriate application of the standards of *United States v. Powell*, 379 U.S. 48 (1964), the Eighth Circuit held unenforceable an IRS summons of the taxpayer's budget proposals for years under examination. *United States v. Matras*, 487 F.2d at 1275. The Court rejected the IRS's contention of a general need for a "road map" to the taxpayer's tax returns and affirmed the district court holding that records of actual transactions and not budgets are relevant to a determination of the taxpayer's liability. *Id.*

In each of the above cases the Service sought production of analyses by the taxpayer or its independent auditor to gain access not to *factual* information respecting the taxpayer's tax liability or the correctness of its return but, rather, to the taxpayer's analyses and thought processes.[2] Although the taxpayer's theories and opinions regarding positions taken on its tax return may be convenient for the IRS in conducting an examination of the taxpayer's return, *convenience* does not equate to *relevance*. *Coopers & Lybrand*, 550 F.2d at 621; *Matras*, 487 F.2d at 1275.

The standard of relevance pressed for by the respondent in this case that the analyses in question might shed some light upon the taxpayer's return is overbroad. Publicly held corporations often have tax departments comprised of attorneys and accountants; tax premises are built into economic evaluations and forecasts prepared by a corporation. When pressed to its logical limit, the conception of relevance adopted by the court below has no limitations at all. *Cf. Matras*, 487 F.2d at 1275.

Enforcing the summons issued in this case, where no allegation of fraud or negligence exists, will impede the proper function of corporate tax departments. The

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[2] As Judge Garwood pointed out in his dissent below, the context in which the word "relevant" appears in the statutory provision in question enhances the propriety of the construction that it relates to factual materials. *United States v. El Paso Co.*, 682 F.2d at 548 (Garwood, J., dissenting). Section 7602 refers to "books, papers, records and other data." These terms are commonly thought to refer to factual materials. The word "data" is defined as "things known or assumed; *facts or figures from which conclusions can be inferred*; information." *Webster's New Twentieth Century Dictionary* (2d ed. 1979) (emphasis added). Here the respondent seeks not factual materials from which conclusions can be inferred but the conclusions themselves. *See also* Caplin, *Should the Service Be Permitted to Reach Accountants' Tax Accrual Workpapers?*, 51 J. Tax. 194, 199-200 (1979); Caplin, *Government Access To Independent Accountants' Tax Accrual Workpapers*, 1 Va. Tax. Rev. 57, 68 (1981).

standard adopted would apply not only to analyses and opinions generated in connection with the preparation of financial statements in compliance with federal securities laws but to virtually any document generated by the corporate tax department, and possibly the entire corporation. API submits that this will greatly impede the conduct of business by its member corporations and do away with the standards fashioned by this Court in *United States v. Powell*, 379 U.S. 48 (1964). It will inhibit the free flow of advice emanating from corporate tax departments and undermine the quality and depth of such advice. The policies underlying the self-assessment system, consistent with the policies of the federal securities laws, should encourage, rather than restrict, critical analysis of issues arising under the tax code by corporate tax departments.

II. ATTORNEY-CLIENT PRIVILEGE

This Court in *Upjohn Co. v. United States*, 499 U.S. 383 (1981), settled the question that the attorney-client privilege and the work-product doctrine apply to protect information from compulsory disclosure in a tax summons enforcement proceeding. In *El Paso* the court apparently held that limited disclosure of some of the information and many of the potential tax liability issues constituted a waiver of the attorney-client privilege with respect to the entire compilation of opinions and analyses forming a part of the tax pool analysis. *See* 682 F.2d at 541.

The Fifth Circuit recognized in *El Paso* that corporations must prepare or have prepared for them by their independent auditors an analysis of their contingent tax liabilities in order to comply with the federal securities laws. 682 F.2d at 534. The potential issues must of necessity be discussed between the taxpayer and its independent auditor in order to comply with the federal securities laws. *Id.* The Fifth Circuit further recognized that an analysis of the soft spots on a tax return by an

attorney and his judgment on the outcome of litigation on it were legal advice. *Id.* at 539. To hold that discussion of the potential tax liability issues with the taxpayer's independent public auditor in order to comply with federal securities laws constitutes a waiver of the attorney-client privilege as to all supporting opinions and memoranda, *see* 682 F.2d at 550 n. 14, even though not disclosed, seriously erodes the doctrine recently reaffirmed by this Court in *Upjohn Co. v. United States*, 499 U.S. 383 (1981).

Discussions with the independent auditor are confidential in nature and are unrelated to the filling out of a tax return. Thus, unlike the situation in *Couch v. United States*, 409 U.S. 322 (1973), there is some expectation of privacy on the part of the taxpayer. *El Paso*, 682 F.2d at 539. Judge Garwood, in his dissent below, aptly pointed out that "the reality of the matter is that for publicly held companies very little information can properly be held entirely confidential from independent auditors." *Id.* at 551 (Garwood, J., dissenting). This fact, ignored by the court below, must be accounted for in fashioning rules regarding waiver of the attorney-client privilege. For example, if the ruling of the court below is upheld, then on facts identical to those of *Upjohn Co. v. United States*, discussion by Upjohn of potential tax issues arising from the investigation in that case with its independent public auditors for purposes of determining whether any amount should be included in Upjohn's tax contingency liability in its financial statements would presumably result in a waiver of the attorney-client privilege with respect to all materials protected under that case.

API urges this Court to reverse this holding of the Fifth Circuit because it injects uncertainty into an important area of federal tax law by eroding this Court's opinion in *Upjohn* and because it conflicts with the law in other Circuits. *See Diversified Industries, Inc. v. Mer-*

edith, 572 F.2d 596 (8th Cir. 1977) (*en banc*); *United States v. Upjohn Co.*, 600 F.2d 1223, 1227 n. 12 (1979); *Weil v. Investment/Indicators, Research & Management*, 647 F.2d 18, 25 (9th Cir. 1981).

III. WORK PRODUCT DOCTRINE

1. The Fifth Circuit created a conflict with the Second Circuit's decision in *United States v. Arthur Young & Co.*, 677 F.2d 211 (2d Cir. 1982), by refusing to recognize the need for a work-product privilege for the materials at issue in this case. As noted earlier, in *Arthur Young* the Second Circuit held unenforceable a summons issued to the taxpayer's independent public auditor to produce a tax pool analysis prepared by the taxpayer's independent public auditor. *Id.* at 220. The court weighed the importance of the procedure designed by Congress by its enactment of the federal securities laws to protect the investing public from inaccurate financial information against the argument of the IRS in support of its desire "to summon a roadmap of the thoughts and theories of a taxpayer and its independent public auditor." *Id.* The court held that where the IRS is not attempting to prove fraud, the paramount need of the investing public in accurate financial information required it to fashion a work-product privilege to protect the independent auditing process. *Id.* at 221. *Cf. Donaldson v. United States*, 400 U.S. 517, 530 (1971) (where this Court observed that the materials at issue there were not the work-product of the taxpayer's attorney or his accountant, thereby preserving the issue for the future). The considerations weighed by the Second Circuit in holding the summons in *Arthur Young* unenforceable apply with undiminished force to the taxpayer. The "independent auditing process" sought to be protected is one in which both the taxpayer and its independent auditor partake. Indeed, the failure to apply the *Arthur Young* rationale to materials prepared by the taxpayer in this case would defeat its purpose.

The *Arthur Young* holding shields the independent auditor from tax summons enforcement proceedings under the work-product privilege fashioned in that case. However, the holding in *El Paso* would require the taxpayer to produce the tax pool analysis or to testify as to its contents. Moreover, the taxpayer would not be protected where the same analysis was performed by the taxpayer instead of the independent auditor, even though the materials are prepared by an attorney. API believes that the policy underlying the federal securities laws requires that the analysis of the potential tax liability of a taxpayer extend equally to the independent public auditor and the taxpayer, whether prepared by the independent auditor, the taxpayer or both in conjunction. The subject matter and the analysis are the same, regardless of by whom it is prepared.

2. The court below held that analyses prepared by the attorneys for the Petitioner did not constitute "work product" under the doctrine first set forth in *Hickman v. Taylor*, 329 U.S. 495 (1947). The Fifth Circuit recognized that the analysis by an attorney of the soft spots in a tax return on the outcome of litigation on it are legal advice but did not recognize that they were being assembled and brought into being in anticipation of litigation. *El Paso*, 682 F.2d at 543. API submits that this ruling miscontrues the nature of the tax accrual analysis. The tax liability contingency in the financial statements is generated precisely because of the likelihood of challenge by the Government and subsequent litigation. The analysis identifies which issues are likely to be the subject of litigation and then makes an educated guess on the likely outcome. If the IRS was not expected to challenge the taxpayer's return, there would be no need for the tax contingency. In *Upjohn v. United States*, this Court recognized that materials prepared "to supply a basis for legal advice concerning compliance with securities and tax laws . . . and potential litigation in each of these areas . . ." were within the work-product doc-

trine. 449 U.S. at 394. The failure of the court below in *El Paso* to recognize that the materials in question were subject to the work-product doctrine conflicts with *Upjohn*.

3. Aside from the important issue raised regarding the scope of the work-product doctrine in the context of the tax pool analysis, the holding by the Court that the work-product doctrine does not apply because outside counsel "handled" litigation and the corporate counsel acted only as co-counsel in litigation, raises a question of federal law of importance beyond the tax issues present in this case which this Court should address. Holding that materials prepared in anticipation of litigation are not covered under the work-product doctrine simply because they are prepared by corporate counsel not taking the lead in litigation ignores the reality of the way business is done today by a great number of corporations and law firms. Further, in *Upjohn Co. v. United States*, 449 U.S. 383 (1981), all the materials at issue were prepared by corporate counsel and the decision gives no indication that any weight is to be accorded to whether corporate counsel takes the lead in litigation or not. The opinion of the court below injects considerable uncertainty into what, up to now, was considered by most a settled area of law. API urges this Court to reject the novel position taken by the court below.

IV. POLICY

The importance of the issues raised in this case to the administration of the federal tax and securities laws is not disputed.[3] The interest of the IRS in effective en-

[3] The First Circuit noted the need for critical analysis and guidance in this area of law. The court stated: "The importance of the interests of all concerned—taxpayers, accountants and IRS—is clear. That a resolution sensitively reflecting the legitimate interests of all and faithful to applicable statutes would involve the most delicate and demanding analysis of facts, research of law and reflection on

forcement of the tax code, embodied in 26 U.S.C. § 7602, is not without limits. This Court has stated that the summons authority claimed should be "*necessary* for the effective performance of congressionally imposed responsibilities to enforce the tax code . . ." and that the summons authority should be weighed against "express prohibition or *substantial countervailing policies.*" *United States, et al. v. Euge*, 444 U.S. 707, 711 (1980) (emphasis added).

API submits that the summons authority sought here is not *necessary* for the effective enforcement of the tax code and that it is in derogation of countervailing policies enunciated by Congress. As noted earlier and as stated by the Second Circuit, "so long as a case does not involve allegation of fraud, the Service does not need to know taxpayer's thoughts." *Arthur Young*, 677 F.2d at 220. API does not understand the respondent in this case to say that the audit could not be completed without the tax pool analysis. Convenience, not necessity, is the Government's objective.

Substantial countervailing policies are at work here. Firstly, the congressional objective of securing for the investing public accurate financial information is apparent. The taxpayer and its independent auditor *must* undertake a tax pool analysis to comply with SEC financial reporting requirements. Making the tax pool analysis subject to the IRS's summons authority in the absence of fraud allegations will inhibit the independent auditing practice. Taxpayers will be wary of disclosing confidential information about their thoughts and theories regarding tax positions to their independent public auditor if this becomes an effective disclosure of the same information to the IRS. The depth and quality of the tax pool analysis would in-

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policy is equally clear." *United States v. Arthur Andersen & Co.*, 623 F.2d 725, 729 (1st Cir. 1980); *see also United States v. Arthur Andersen & Co.*, 623 F.2d 720 (1st Cir. 1980).

evitably suffer. *Cf. Upjohn Co. v. United States*, 449 U.S. at 393 n. 2; *Arthur Young*, 677 F.2d at 220 n. 9.

Secondly, the requirement in *United States v. Euge*, 444 U.S. 707 (1980), that the summons authority claimed to be necessary for enforcement of the tax code could itself be viewed as an expression of the congressional policy set forth in 26 U.S.C. § 7605(b) that taxpayers not be subject to unnecessary examination investigation.

Thirdly, the adverse impact on the self-assessment system of taxation of allowing the IRS to delve into the mind of the taxpayer by obtaining the tax pool analysis was noted by former IRS Commissioner Caplin. *See* Caplin, *supra*, 1 Va. Tax. Rev. at 82. The Second Circuit in *Arthur Young* also noted that requiring the taxpayer alone to disclose settlement positions contained in a tax pool analysis would improperly weigh the balance presently existing between collecting revenue and conserving judicial resources. 677 F.2d at 220. API submits that these policies should be considered by this Court in reviewing the petition in the instant case.

Fourthly, the unwarranted attempt by the IRS to reach these materials under 26 U.S.C. § 7602, a longstanding statute, is more appropriately left to Congress. The Second Circuit, in *Arthur Young*, in concluding that the summons in that case should not be enforced, stated:

> In reaching this conclusion, we are comforted by the knowledge that if Congress feels that this privilege unduly restricts the IRS' authority, it can require that this material will be made available, or that taxpayer's flag their questionable positions directly on their returns in line with the suggestions of Former Commissioner Kurtz [citation omitted]. Procuring tax accrual workpapers under Section 7602 seems to us to effectuate Commissioner Kurtz's proposal through the back door.

677 F.2d at 221.

Congress has indeed acted with much more precision than the IRS in this case. *See* Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, § 323 1982 U.S. Code Cong. & Ad. News (96 Stat.) 324. Congress has seen fit to require taxpayers to disclose on their returns positions which lack substantial authority or to face the consequences of underpayment penalties. The IRS's concern with delving into the mind of the taxpayer in this case was resolved by Congress in a much more limited and appropriate fashion.

Finally, the impact of this case on the policies expressed in *Upjohn* should be considered by this Court. Taxpayers should be free to discuss confidentially potential issues and exchange thoughts and theories with their professional advisors without fear that the IRS will subsequently gain access to such materials and testimony about them.

CONCLUSION

The petition for a writ of certiorari should be granted in this case to resolve the conflict in the courts of appeal and provide needed guidance to the lower courts and taxpayers on the important and recurring questions of federal law discussed above.

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IN THE

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OCTOBER TERM, 1982

THE EL PASO COMPANY,
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v.
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Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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BRIEF AMICUS CURIAE ON BEHALF OF THE CHAMBER OF COMMERCE OF THE UNITED STATES IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

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BRIEF AMICUS CURIAE ON BEHALF OF THE CHAMBER OF COMMERCE OF THE UNITED STATES IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

STATEMENT OF INTEREST[1]

The Chamber of Commerce of the United States ("Chamber") is the largest federation of business organizations and individuals in the United States. It has a total membership in excess of 245,000, including over 240,000 corporations, partnerships and individuals, as well as 1,350 trade associations, and 2,700 local and state chambers of commerce. The Chamber regularly presents

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[1] This brief is filed with the written consent of the parties pursuant to Supreme Court Rule 36.1.

its members' views to this Court and the lower federal courts on matters of major concern to the business community.[2]

The ultimate issue presented here, whether the Internal Revenue Service ("IRS" or "Service") can obtain access to a publicly held corporation's tax analysis (or accrual) workpapers, directly affects a substantial number of the Chamber's corporate members. It also concerns the Chamber's non-public corporate members, since the IRS actions in this context raise the spectre that it might take the same position with the non-public segment of the corporate community. These papers contain a corporation's "worst case" estimate of its contingent tax liability based on the issues it thinks might be raised in an audit of its tax returns, and its speculation concerning the ultimate resolution of those issues. As such, they constitute a road map to a corporation's negotiating and settlement positions on issues discussed therein.

The concern of the Chamber's members is heightened by the fact that preparation of the tax accrual workpapers is not a discretionary matter for publicly held corporations. To the contrary, the Securities and Exchange Commission ("SEC") requires publicly held corporations to periodically file audited financial statements. SEC Regulations,[3] and the standards of the accounting profession[4] require that these financial statements dis-

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[2] *See e.g., Newport News Shipbuilding and Drydock Co. v. EEOC*, (No. 82-411) (*Petition for cert. granted*, December 6, 1982); *Metropolitan Edison Company, et al. v. People Against Nuclear Energy, et al.* (Nos. 81-2399, 82-358) (*Petition for Certiorari granted* November 1, 1982); *Upjohn Co. v. United States*, 449 U.S. 383 (1981); *First National Maintenance Corp. v. NLRB*, 449 U.S. 1076 (1981); *Gould Corp. v. NLRB*, 612 F.2d 728 (3rd Cir. 1979).

[3] Regulation S-X, 17 C.F.R. § 210.1-02(n) (1981).

[4] American Institute of Certified Public Accountants, Statement on Auditing Standards No. 1 § *110.01* (1973); Financial Accounting Standards Board, Statement of Financial Accounting Standards No. 5 (1975).

close "material contingent liabilities." The possibility of additional tax liability is normally considered to be a material contingent liability.

Moreover, the decision of the United States Court of Appeals for the Fifth Circuit below will interfere with the ability of the management of publicly held corporations to have full and frank discussions with their attorneys and independent auditors. This is of obvious concern to the large number of publicly held members of the Chamber.

Finally, the fact that the appellate courts that have addressed the issue in this case have reached differing results[5] presents difficult problems for the many Chamber members with multistate operations. It is at best an awkward situation for such multistate concerns to have their tax analysis workpapers subject or not subject to subpoena depending on the geographic location where the subpoena is sought. Resolution of these issues by this Court would eliminate the problem by establishment of a uniform national rule. For these reasons, the Chamber respectfully submits its brief.

REASONS FOR GRANTING THE WRIT[6]

SUMMARY OF ARGUMENT

Tax accrual workpapers are a corporation's estimate of its tax liability for a particular year after all tax audits, negotiations, and litigation of contested areas are completed. The workpapers are not used in any way to assist in preparation of the corporate tax return, but

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[5] In addition to the instant case there are holdings of the Tenth Circuit in *U.S. v. Coopers & Lybrand*, 550 F.2d 615 (1977), the Second Circuit in *U.S. v. Arthur Young & Co.*, 677 F.2d 211 (1982), *petition for cert. filed*, No. 82-687 (Oct. 20, 1982), and the related opinion of the Eighth Circuit in *United States v. Matras*, 487 F.2d 1271 (1973).

[6] In order to avoid unnecessarily burdening the Court, the Chamber incorporates by reference the Petitioner's Statement of the Case.

rather are created independently of the preparation of the return.

In large part, these workpapers are created to comply with Securities and Exchange Commission Regulations designed to insure that investors receive accurate data on the financial conditions of public corporations. Because disclosure of these workpapers to the I.R.S. would inhibit frank communications between corporations, and their accountants and attorneys, there is a basic tension between the policies underlying the securities regulations, and the I.R.S. attempts to obtain these documents. The significance of these policies make this case worthy of Supreme Court review.

Whether or not these workpapers must be disclosed to the I.R.S. as part of the normal audit procedure has provoked a great deal of litigation, with conflicting decisions from the circuit courts. The circuits have variously held that the workpapers are not relevant to a legitimate inquiry by the I.R.S.,[7] and that they are relevant, but are protected by a work-product privilege.[8] Because the interaction of national corporations with a national agency is at stake, these conflicting decisions should be addressed by this Court.

I. This Case Presents A Basic Conflict Between The Policies Of The Securities And Exchange Laws And The Internal Revenue Service Which Should Be Resolved By This Court.

As we stated above, SEC Regulations requiring the periodic filing of audited financial statements and generally accepted accounting principles implicitly require the preparation of a tax pool analysis (also referred

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[7] *United States v. Coopers & Lybrand*, 550 F.2d 615 (10th Cir. 1977); *see also United States v. Matras*, 487 F.2d 1271 (8th Cir. 1973).

[8] *United States v. Arthur Young & Co.*, 677 F.2d 211 (2d Cir. 1982), *pet. for cert. filed*, No. 82-687 (Oct. 20, 1982).

to as tax accrual workpapers.) Such an analysis may be prepared either by the taxpayer or its independent accountant, but in either case it must be reviewed by the independent auditor in accordance with generally accepted auditing standards. As the U.S. Court of Appeals for the Second Circuit noted in *U.S. v. Arthur Young & Co.*:

> . . . generally accepted accounting principles require an auditor to determine whether his client has put aside enough reserves to cover the contingency that, upon audit, it will owe the government more taxes than originally remitted.
>
> • • •
>
> In areas where the [Tax] law is unclear, he must predict the chances that the taxpayer's position will be upheld by the courts—a judgment based on his knowledge of the law and his opinion of where the law is headed.

677 F.2d 211 at 217 (1982). *Pet. for cert. filed*, No. 82-687 (Oct. 20, 1982).

The rationale behind this exercise is obvious. There is a strong public policy behind the securities laws encouraging the fullest and most accurate disclosure of a corporation's financial condition to investors and potential investors. The Chamber fully supports this policy, and in fact its policy manual states, "[i]t is essential that legislation which assures investors of the availability of adequate information regarding proposed issues of securities continue in force."* It is equally obvious that in order for investors to have the most accurate information, the fullest and frankest discussions must take place between corporations, and their attorneys and accountants. *U.S. v. Arthur Young & Co.*, 677 F.2d at 218-221.

But disclosure of the tax pool analysis to the I.R.S. will greatly inhibit this communication. In *United States*

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*Policy Declarations Adopted by the Chamber of Commerce of the U.S. pp. 183-184 (1981).

v. Coopers and Lybrand, a Past President of the American Institute of Certified Public Accountants testified:

> . . . I would not presume to suggest, Your Honor, that a taxpayer, be it a large corporation or a small one, be empowered in any way to withhold the facts on which they have based their income tax return or the basis on which they have computed their tax. This certainly is part and parcel of our system of self assessment, and were we to eliminate that, the Government would be terribly hampered, but what I'm concerned about is this ability of the Government to look into the client's mind to determine not what the facts are on which the tax is based, but what the worst possible nightmare is the client can conceive can happen if every assumption on which he based his tax were to go against him in some kind of litigation.
>
> He may think up contingencies even more lurid than the worst contingencies a revenue agent comes up with, and with that information available to the revenue agent just for the asking, I think eventually destroy the system of auditing that we have established because it would eliminate the freedom that the client feels of being able to muse with us about, well, what if this capital gains is treated as an ordinary income? What are the potentials? What are the chances? Well, the chances are 60-40 or 90-10, one way or the other.
>
> * * *
>
> If we were hampered in any audit situation by the fact that the client knows that if he gives us any data about that its going to be readily available to Government, I cannot imagine how we would be able to render audit opinions for that client for very long. It would just absolutely cut off our communication. . .

413 F. Supp. 942 at 953-954 (D.Colo. 1975), *aff'd.* 550 F.2d 615 (10th Cir. 1977).

The decision of the Fifth Circuit below is fundamentally at odds with the holding of the Second Circuit

in *Arthur Young*, *supra*, and the Tenth Circuit in *Coopers & Lybrand*, *supra*.[10] The importance of the competing policy considerations, and the differing resolutions of the issues by the circuit courts weigh heavily in favor of this court granting review here.

II. The Fifth Circuit Erred In Holding That El Paso's Tax Analysis Workpapers Are Relevant To An I.R.S. Investigation.

In preparing a tax pool and analysis:

> . . . the auditors and corporate management engage in a worst-case analysis of the tax treatment of selected items on the corporation's return. A worst case tax assessment is then computed and a portion of this amount is accrued or reserved. *This process takes place separately from the preparation of the actual tax return*, regardless of whether the corporation also has engaged the auditing firm to prepare the corporation's tax return. (footnotes omitted)

Note, *A Balancing Approach to the Discoverability of Accountants' Tax Liability Workpapers Under Section 7602 of the Internal Revenue Code*, 60 Wash. U.L.Q. 185 (1982).

Precisely because preparation of this analysis is done independently of preparation of the corporation's tax return, and is in no way a factual predicate for the company's tax return, the analysis should not be considered relevant to an I.R.S. investigation.[11] *U.S. v. Coopers & Lybrand*, *supra*.

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[10] While the Second Circuit based its holding on the existence of a work-product privilege, and the Tenth Circuit based its holding on relevance grounds, both Courts recognized the competing policy considerations, and resolved them against the IRS.

[11] An allegation of fraud by the Service may well lead to a different conclusion as to the relevance of the analysis. But no allegation of fraud has been made here, and that question can therefore be left for another case.

The holding of the Tenth Circuit in *Coopers and Lybrand*, *supra*, on this point, which is diametrically opposed to that of the Fifth Circuit below, recognized this distinction.[12] There the Tenth Circuit flatly rejected the I.R.S.'s contention that the company's tax pool analysis was relevant to an I.R.S. audit.

In so holding the Tenth Circuit found that:

> "The Tax Pool Analysis file and related papers were not issued or compiled in connection with the preparation or filing of the [company's] income tax returns.
>
> • • •
>
> The limited purpose for which the Tax Pool was created by [the company] and communicated to [the accountants] was unrelated and distinct from [the company's] tax liability or the preparation of [the company's] tax return.

550 F.2d 615 at 618.

In holding that the tax pool analysis was not relevant, the Tenth Circuit cited the Eighth Circuit's opinion in *U.S. v. Matras* for the proposition that the I.R.S. cannot summon documents pursuant to section 7602 merely for the convenience of the Service.[13] 550 F.2d at 620-621. Quoting from the Eighth Circuit, the Tenth Circuit stated:

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[12] In this regard, the Fifth Circuit stated, "We reject the view that the tax pool analysis fails the relevance test."

[13] In *Matras*, *supra*, the Eighth Circuit stated that the test of relevance under section 7602 of the Internal Revenue Code (26 U.S.C. § 7602) is whether the sought after documents "might have thrown light upon the correctness of the taxpayer's return." 487 F.2d at 1274. Whether "light is thrown must be a 'realistic' expec-

> "If we were to accede to the government's view, it is difficult to imagine corporate materials that might not contribute to a more comprehensive understanding of the workings of the corporation, and thus, according to the government, be deemed relevant to the tax investigation."

550 F.2d at 621, *quoting U.S. v. Matras*, 487 F.2d at 1274-1275.

The Chamber firmly believes in the correctness of the Tenth Circuit's holding in *Coopers & Lybrand*, and the related holding of the Eighth Circuit in *Matras*. At the very least, however, we urge this Court to resolve the hopeless split among the circuits. For not only are the Tenth and Eighth Circuit opinions at odds with the Fifth Circuit below but they are at odds with the Second Circuit, as well. Although, the Second Circuit in *U.S. v. Arthur Young*, *supra*, ultimately determined that the Service could not have access to the company's tax pool analysis, it did so on the basis of a work-product privilege. On the question of relevance, however, the Second Circuit expressly disagreed with the Tenth Circuit and the Eighth Circuit. 677 F.2d at 218. Because the Circuits are hopelessly deadlocked on an issue of major importance to all publicly held corporations, the Chamber urges this Court to grant the petition.

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tation, rather than an idle hope." *Id.* The Court then went on to say:

> Certainly, a taxpayer should not erect roadblocks for the purpose of frustrating or preventing the I.R.S. from a full scale inquiry of the liability of the taxpayer. By the same token, the government should not for the mere sake of its convenience, impose unnecessary burdens on a taxpayer in conducting an audit or investigation for tax liability, particularly, where, as here, there is no indication of a purpose to escape any tax liability. The term "relevant" connotes and encompasses more than "convenience."

Id. at 1274-1275.

III. This Court Should Resolve The Differing Circuit Opinions Regarding The Application Of The Work-Product And Attorney-Client Privileges.

In *U.S. v. Arthur Young*, *supra*, the Second Circuit, although finding the tax pool analysis to be relevant, found "that the countervailing policies at issue in the case before us require us to fashion protection for the work that independent auditors, retained by publicly owned companies to comply with the federal securities laws, put into preparation of tax accrual workpapers." 677 F.2d at 219. In so holding the Second Circuit relied on this Court's ruling in *Hickman v. Taylor*, 329 U.S. 495 (1947), which established a policy of protecting attorneys' work product.

Although *Arthur Young* dealt with the work product of accountants, the rationale of the Second Circuit's decision applies with equal force when the tax pool analysis is prepared by the taxpayer. In each case it is necessary to balance the competing public policies of the securities and revenue laws.

Again the circuits are at odds. The Fifth Circuit essentially brushed this problem aside, finding that *El Paso* had waived the attorney-client privilege by showing the documents to its independent auditors and, moreover, that a work-product privilege did not protect the documents. Slip op. at 4155. This conflict deserves resolution by this Court. Caplin, *Government Access to Independent Accountants' Tax Accrual Workpapers*, 1 Va. Tax Rev. 57, at 80 (Spring, 1981).

The Chamber believes that there are significant policy considerations militating in favor of the Second Circuit's resolution of the problem. As a former I.R.S. Commissioner has stated:

> The policy arguments for limiting the Service's access to accountants' tax accrual workpapers are persuasive. Candid communication between accountant and client is at stake, as well as protection of the

integrity of the financial audit process and the public interest in full disclosure in corporate financial statements. An additional concern is the adverse impact of the tax accural controversy on the nation's self-assessment system. The federal income tax system is based upon cooperation by the public through voluntary compliance and self-assessment of taxes. To preserve this process, the Service must treat taxpayers in a fair, evenhanded manner, and demonstrate to the public that it is doing so. (footnotes omitted).

Id.

CONCLUSION

For all the foregoing reasons, the Chamber of Commerce respectfully urges the Court to grant The El Paso Company's Petition for a Writ of Certiorari.

Respectfully submitted,

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BRIEF OF CHEMICAL MANUFACTURERS ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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BRIEF OF CHEMICAL MANUFACTURERS ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

The Chemical Manufacturers Association (CMA) submits this brief *amicus curiae* in support of the petition for a writ of certiorari filed by The El Paso Company. CMA supports this Court's review of all of the issues presented by the petition.[1]

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[1] Written permission from the parties to this litigation to file this brief as *amicus curiae* has been obtained and has been filed with the Clerk of this Court.

INTEREST OF THE AMICUS CURIAE

The Chemical Manufacturers Association is a nonprofit trade association representing more than 90 percent of the production capacity of basic industrial chemicals within this country. The El Paso Company, the petitioner in this case, is a holding company of several corporations, one of which, The El Paso Products Company, is a member of CMA.

A divided panel of the United States Court of Appeals for the Fifth Circuit in this case affirmed the judgment of the United States District Court enforcing an Internal Revenue Service (IRS) summons issued to The El Paso Company, calling for the production of its "taxpool analysis", an analysis made by The El Paso Company to determine the adequacy of its reserves for contingent tax liabilities and comply with the financial reporting requirements of the securities laws. The court held, in pertinent part, that the taxpayer's tax pool analysis, and any supporting memoranda used in its preparation, summoned by the IRS were relevant to determining the correctness of certain of El Paso's tax returns, that the tax pool analysis and such supporting memoranda were protected neither by the attorney-client privilege nor by the work-product doctrine, and that the public policies reflected in federal securities laws did not require denial of enforcement of the summons.

The Fifth Circuit's decision is of vital importance to chemical companies, as it is to all publicly-held corporations. Many CMA member companies are large, publicly-held companies engaged in a myriad of complex transactions on a worldwide basis. As a result, the ultimate tax liability of each company is also a complex determination, and reserves must be established to provide for any contingent liability. The judgments, opinions, and thought processes of company officials as to the likelihood and amount of that liability should not be discoverable by the Internal Revenue Service.

ARGUMENT

This case, along with *United States* v. *Arthur Young & Co.*, 677 F.2d 211 (1982), petition for cert. filed, No. 82-687 (Oct. 20, 1982), involves the limits of the summons power of the Internal Revenue Service under 26 U.S.C. § 7602. The issues involved in the two cases are extremely important in the administration of the tax laws, and if the summons power is upheld in these cases, the scope of Internal Revenue Service audits would be redefined. Additionally, disclosure of contingent tax liabilities by publicly-held corporations would, to the detriment of the investing public, be less open.

The initial and primary question presented by the case is the relevance in an IRS audit of a taxpayer's tax pool analysis. The Fifth Circuit has defined relevance so broadly as to have very few limits. The term has been defined as an absolute, without regard to the circumstances of its application. CMA maintains that relevance must be examined in the context of public policy and with due regard to all surrounding circumstances. This case therefore presents the Court with an opportunity to consider whether there are meaningful limits to relevance in IRS audits and whether public policy and other balancing factors might affect those limits.

The tax pool analysis is not prepared as part of, or in furtherance of, a taxpayer's tax return. The tax pool analysis is often not prepared contemporaneously with the tax return. In simplest terms, the tax pool analysis is merely an estimate of a company as to what its final tax liability may be after all gray areas are resolved in the audit and subsequent administrative and judicial processes. The format and detail of the tax pool analysis may differ among taxpayers, but The El Paso Company's tax pool analysis appears typical. That analysis identifies questionable issues, speculates on the likelihood that those issues will be raised, evaluates the merits of the issues,

projects a future settlement posture, and estimates the overall final outcome.

It is important to note that a tax pool analysis may not include facts or data that were used in preparation of the tax return or that bear on final tax liability. It is this non-factual material that is involved in this case. The only claim of relevance that can be made as to this material is that the tax pool analysis provides a convenient roadmap for expeditiously auditing a taxpayer's return.

The definition of relevance used by the Fifth Circuit in this case, as well as by the Court of Appeals in the *Arthur Young* case, is whether the document sought "might throw light upon the correctness of the taxpayer's return". 682 F.2d 537, quoting *United States* v. *Wyatt*, 637 F.2d 293, 300 (5th Cir. 1981). This test of relevance is extremely broad and contrary to the test adopted by the Tenth Circuit in *United States* v. *Coopers & Lybrand*, 550 F.2d 615 (1977). The Tenth Circuit applied a balancing test of relevance rather than considering the term as an absolute. In effect, relevance must be tempered by the context in which it is applied.

The relevance of the tax pool analysis to the Internal Revenue Service is very limited. If the analysis is not available to the IRS, the IRS is still able to complete a thorough audit. The analysis is not necessary to completion of the audit; it would merely speed up a determination of issues that should be closely examined. At the same time, availability of the analysis to the IRS would unfairly give the IRS the taxpayer's own judgment of its settlement and litigating positions.

All persons familiar with our federal tax system know that the tax laws are extremely complex and that there are many questions of application and interpretation that have yet to be decided. On every large corporate tax return, there are questions of proper tax treatment that have no definite answer. Our self-assessment system re-

quires that answers be given in preparing the tax return, but it does not require that the answers on the return be resolved unfavorably to the taxpayer. The taxpayer is entitled to interpret the law in its favor, and an extensive administrative and judicial process has been established to resolve differing interpretations. On a practical level, experience shows that a taxpayer is severely disabled in that administrative and judicial process if its evaluations of its strengths and weaknesses and its settlement and litigating positions are known to the government. There is a sense of unfair play in giving the government such knowledge.

It is in this context of the impact on our self-assessment system that the relevance of the tax pool analysis must be judged. That relevance must also be considered in the light of its impact on the federal securities laws.

The tax pool analysis is required in order that an independent auditor may certify a company's financial statements, which must be periodically filed with the Securities and Exchange Commission. If the tax pool analysis is not subject to IRS summons, as has been generally believed until recently, the taxpayer company has no reason to hold back in its discussions with its independent auditors from a frank and complete disclosure of its evaluations and judgments on all potential tax issues. This means that the investing public will receive the benefit of the best financial information available concerning a company. If this Court should hold that the tax pool analysis is subject to summons by the IRS, companies will still meet their financial reporting requirements but not to the full extent that they now disclose. There is a wide range of discretion in determining the extent of disclosure under current auditing standards, and companies will certainly be more guarded in their disclosure policies if such information is ultimately available to the Internal Revenue Service.

As the petition for certiorari points out, the issue of the availability of the tax pool analysis has been the subject of much public comment in recent years. Proposals have been advanced for requiring taxpayers on their tax returns to identify questionable items. In the Tax Equity and Fiscal Responsibility Act of 1982, Congress did not adopt such a requirement but did adopt a more limited provision to encourage taxpayers to set forth questionable items. In section 323(a) of that Act (codified at 26 U.S.C. § 6661), a penalty is provided for substantial underpayments of tax, but the penalty will not apply if the taxpayer has adequately disclosed the relevant facts respecting its return position or if there is substantial authority for that position. Note that the disclosure is of relevant *facts* and does not involve estimates, evaluations, or judgments of a taxpayer's position. The summons authority of the Internal Revenue Service found in 26 U.S.C. § 7602 must be viewed through this recent indication of Congressional intent.

If the primary question of relevancy is decided in favor of upholding the IRS summons, this case raises the no less important issue of the applicability of the work product privilege. The Second Circuit in the *Arthur Young* case held that a work product privilege protects the tax pool analysis from a summons (except for a sufficient showing of need). The summons in *Arthur Young* was directed to the independent auditors, and if the work product privilege as set forth in *Arthur Young* is upheld, it must be decided whether that privilege extends to a tax pool analysis prepared by, and in the hands of, a taxpayer. If the privilege does not so extend, then it is of little value.

A further important question is raised by the petition. The El Paso Company's tax pool analysis was prepared under the direction of lawyers. The Court of Appeals held that any attorney-client privilege that might have arisen in such circumstances is waived by disclosure of

the analysis to the outside auditor, even though the auditor is under strictures of confidentiality and even though the disclosure is effectively required by federal law. Such a holding places severe limitations on the modern-day usefulness of the attorney-client privilege, and this Court should review the holding.

CONCLUSION

The El Paso Company's petition for a writ of certiorari should be granted.

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THE EL PASO COMPANY,
Petitioner,

v.

UNITED STATES OF AMERICA, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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BRIEF OF INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA AS AMICUS CURIAE IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

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BRIEF OF INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA AS AMICUS CURIAE IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

INTEREST OF AMICUS CURIAE

The Interstate Natural Gas Association of America ("INGAA") is a non-profit national trade association representing virtually all of the major long-distance natural gas transmission companies in the United States. These companies conduct their operations over a broad geographic area, including jurisdictions in each of the federal circuits which have issued conflicting decisions on the issues involved in this case.

Nearly all of INGAA's members are public companies subject to the financial reporting requirements of the federal securities laws and all are subject to the federal tax laws. Accordingly, the ultimate resolution of the question whether the IRS may freely summon such tax pool analyses, either from the companies themselves or their inde-

pendent accountants, is a matter of vital concern to INGAA's members. For the reasons stated herein, INGAA urges this Court to grant The El Paso Company's ("El Paso") petition for a writ of certiorari to review the decision of the United States Court of Appeals for the Fifth Circuit in this case.

CONSENT OF THE PARTIES

Amicus is filing this Brief with the consent of both parties, whose letters of consent have been filed with the Clerk.

SUMMARY OF ARGUMENT

The Fifth Circuit has ruled in this case, contrary to decisions in other circuit courts, that a company's confidential review and analysis of its contingent federal tax liability is not privileged material and may be summoned by the Internal Revenue Service ("IRS") under 26 U.S.C. § 7602. Its ruling on the question of the relevance of the tax pool analysis under 26 U.S.C. § 7602 conflicts directly with the Tenth Circuit's decision in *United States v. Coopers & Lybrand*, 550 F.2d 615 (1977), and implicitly with the Eighth Circuit's decision in *United States v. Matras*, 487 F.2d 1271 (1973). Its ruling that El Paso's tax pool analysis is not privileged conflicts with the Second Circuit's decision in *United States v. Arthur Young & Co.*, 677 F.2d 211, *petition for cert. filed*, 51 U.S.L.W. 3341 (U.S. Oct. 20, 1982) (No. 82-687).

These conflicts * have arisen because of fundamental differences of viewpoint among the circuits on the law and on the proper balance to be struck between the competing public policies implicated in this case. Most importantly, the courts have disagreed on their assessment of the IRS's need for information contained in tax pool analyses, the extent to which the law permits IRS access to

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* These and other instances of conflict on these issues are discussed in El Paso's petition at 11-17.

these analyses, and the extent to which IRS access to these analyses will inhibit the free flow of information between public companies and their independent auditors necessary to the full financial disclosure required by the securities laws. The courts have also disagreed on the question of the fairness of requiring the taxpayer to disclose its negotiating and settlement positions to the IRS.

It is INGAA's position that the issues underlying these fundamental disagreements have now been fully explored in the decisions of the Circuit Courts, and that these issues, both because of their importance and because of the conflicts in the circuits, should now be addressed by this Court. Accordingly, INGAA urges the Court to grant El Paso's Petition For a Writ of Certiorari.

THE TAX POOL ANALYSIS

As is more fully set out in The El Paso Company's petition, at 3-5, a tax pool analysis contains a company's private theories and speculations concerning which issues on its return may be subject to challenge by the IRS, whether the company would find it worthwhile to litigate any or all of these issues if raised, the likely outcome of any disputes if litigated, and the dollar amounts for which the company might be willing to settle these disputes administratively if it chose not to litigate them. The goal of conducting such an analysis is to arrive at a dollar estimate of the outcome of all such disputes. If the dollar amount is material, the company will show the amount as a contingent liability on the audited financial statements filed periodically with the Securities and Exchange Commission ("SEC"). While the company will make public the bottom-line dollar estimate arrived at in its tax pool analysis, the document itself and any underlying material will, as a general rule, be kept confidential and will not be disclosed to the SEC. The SEC requires only that the company's independent auditor review the

analysis in accordance with generally accepted auditing standards.

Tax pool analyses may be prepared by a company in-house or by its outside independent auditors. In either case, however, the document itself and any supporting materials are evaluative, not factual, in nature. The IRS seeks tax pool analyses, not because it cannot conduct an audit without them, but rather because the confidential judgments of the company's tax advisers contained therein provide a "road map" for the audit and, presumably, a very useful guide in any subsequent settlement negotiations. *See Arthur Young, supra*, 677 F.2d at 218-221. In short, the IRS summons these analyses for reasons of its own administrative convenience, not because it would be unable to fulfill its audit function without them.

ARGUMENT

I. Important Considerations of Public Policy Dictate that the Fifth Circuit's Decision be Reviewed by This Court

In its decision, the Fifth Circuit balanced the IRS's need for tax pool analyses against the public policy expressed in the securities laws mandating full financial disclosure, and ruled in favor of permitting the IRS access to tax pool analyses. In its brief policy analysis, the court concluded that the quality of financial reporting would not be diminished at all by permitting IRS access to tax pool analyses. Noting that public companies have a legal obligation to prepare such analyses, the court reasoned that "corporations will [not] dishonor their legal obligations by discontinuing the preparation of tax pool analyses." Appendix to Petition of the El Paso Company for a Writ of Certiorari (hereinafter "App.") at 27a.

This assumes erroneously that the only two choices available to a corporation are to comply or not. As explained above, however, a tax pool analysis is by necessity

a collection of highly subjective judgments to which no strict scale of correct and proper disclosure may be applied. There are many degrees of acceptable disclosure. The free and critical exchange of ideas between a company and its independent auditor necessary to develop a full, worst-case analysis of potential tax liability cannot help but be inhibited when it is clear both to the company and its auditor that any exchange between them may become the subject of compelled testimony at a subsequent IRS summons enforcement proceeding. It is undoubted that corporations will continue to produce tax pool analyses as required by law, but it is equally certain that these analyses will be less thorough and searching than before, even though in full compliance with law, if they, or testimony concerning them, may be subject to IRS scrutiny. It is this inhibition of the most full and candid exchange possible between auditor and client, and the ultimate ill effect this will have on the quality of those analyses and financial reporting in general, that is a matter of deep concern requiring the Court's attention.

A second public policy concern meriting this Court's attention is the manifest unfairness of requiring the taxpayer to disclose its negotiating and settlement positions without placing a corresponding requirement on the Government. There can be little doubt that any controversies arising between the taxpayer and Government as a result of an audit involve an adversary process, *see Arthur Young*, *supra*, 677 F.2d at 219-220; Kurtz, *Discussion on "Questionable Positions,"* 31 Tax Law. 13, 14 (1978), yet no such unfairness would be countenanced in an ordinary adversary proceeding.

This is not a case where the taxpayer is suspected of fraud or is trying in bad faith to avoid paying tax due. The Fifth Circuit expressly recognized that the many ambiguities and gray areas of the tax code "guarantee that a large corporation has many opportunities to choose *in good faith* an interpretation of the tax code that leans

toward lessening its taxes." App. 5a (emphasis added); *accord Arthur Young*, *supra*, 677 F.2d at 220. Consequently, the IRS has no need to use this information to establish intent to evade taxes. Moreover, as discussed above, it does not need this information to provide the facts needed for its audit.

It is very likely, then, that the IRS practice of compelling the disclosure of this information based upon considerations of its own convenience, will be perceived as unjust and as an abuse of power. Since our system of taxation is founded on the principles of self-assessment and voluntary compliance, any perception of Government unfairness is inherently damaging to the foundation of that system. Thus, this issue is one of fundamental importance to our tax system and should be considered by this Court.

II. Tax Pool Analyses and Supporting Materials are Privileged and Should Not be Subject to IRS Summons Power

In addition to the public policy concerns identified above, this case presents in a clear and factually uncomplicated setting important questions concerning both the scope of the work product privilege recognized in *Arthur Young* and the attorney-client privilege. On the work product question, the decision of the court below is in clear conflict with the Second Circuit's *Arthur Young* decision, even though the Fifth Circuit decision skirts any in-depth discussion of *Arthur Young*.

In *Arthur Young*, the Second Circuit considered whether a tax pool analysis prepared and maintained by the taxpayer's independent accountant could be summoned by the IRS under section 7602. The court balanced the IRS's need for the analysis in carrying out its function under the tax laws against the public interest expressed by the securities laws in full financial disclosure. Finding that the IRS sought the analysis principally for reasons of

time and efficiency, and that the harm caused to financial reporting by permitting free access to tax pool analyses would be significant, the court recognized a work product privilege to protect such analyses. This privilege was intended to protect such analyses from disclosure unless the IRS could make a showing of sufficient need to outweigh the policy considerations dictating the analyses' protection. The court's intent in *Arthur Young*, it said, was to protect "the integrity of the independent auditing process." 677 F.2d at 221.

While this privilege protected an analysis which was in the hands of the taxpayer's accountant in *Arthur Young*, the court's reasoning is equally applicable where the analysis is sought from the taxpayer itself. The decision would be meaningless if the IRS, denied access to the analysis by the accountant, could then obtain it, or testimony concerning it, from the taxpayer, yet that is the effect of the Fifth Circuit's decision. The Fifth Circuit acknowledges this conflict only obliquely (App. 19a n.13), and largely ignores the import of the *Arthur Young* holding. It is clear, however, that these decisions are in direct conflict, and that the legal issue considered in *Arthur Young* is presented with equal force in this case.

Even if El Paso's tax pool analysis were not protected by the work product doctrine, it should be protected by the attorney-client privilege. The Fifth Circuit acknowledged that under this Court's decision in *Upjohn Co. v. United States*, 449 U.S. 383 (1981), the attorney-client privilege applies in this context, but held that El Paso waived the privilege by disclosing the analysis to its independent auditor. App. 19a. The court relied on this waiver theory even though it was clear that the disclosure of parts of the analysis to the independent auditor was required by law, and even though the confidence was preserved by the auditor. This is not a case where a party invokes the privilege, but then freely discloses the privileged information to others when it is beneficial to do so.

See Green v. Crapo, 181 Mass. 55, 62 N.E. 956, 959 (1902) (Holmes, J.). Rather, it is a case where all precautions have been taken to preserve the confidentiality of the privileged information, and where a limited disclosure has been made, in confidence, in order to comply with the law. The Fifth Circuit's decision constitutes a significant and harmful limitation of the attorney-client privilege and, as noted in El Paso's petition at 16-17, conflicts with decisions of other circuits which hold that a partial disclosure does not constitute a complete waiver of the privilege.

In light of the importance of the work-product and attorney-client privilege issues raised by this case, the considerable confusion the Fifth Circuit's decision has produced concerning the scope of those privileges, and the need to resolve the conflict in the circuits on these issues, INGAA urges this Court to grant certiorari.

III. Tax Pool Analyses are Not Relevant Within the Meaning of 26 U.S.C. § 7602

When balanced against the significant harm to the public interest in reliable financial statements and to taxpayers' interests in preserving the confidential nature of their discussions with accountants and attorneys, the IRS's need for the information contained in tax pool analyses is of secondary importance. It is clear that the IRS does not need to obtain access to tax pool analyses in order to execute its function under the internal revenue laws. As in El Paso's case, the factual material necessary to the audit is ordinarily provided on an ongoing basis during the course of the audit in response to specific requests by the IRS. There is little doubt that access to tax pool analyses may make some aspects of an audit faster and easier for the IRS, but a mere showing of convenience has been held insufficient to establish relevance. *United States v. Matras*, *supra*, 487 F.2d 1271 (IRS denied ac-

cess to taxpayer's proposed budget). As noted above, the tax pool analysis sought in this case, and tax pool analyses in general, do not contain facts not otherwise provided, or available, to the IRS. Moreover, where fraud is not charged, the analysis is not needed to establish intent.

The IRS and the Fifth Circuit both suggest that any information which might shed light upon a taxpayer's return is relevant under 26 U.S.C. § 7602. The Tenth Circuit held in *Coopers & Lybrand*, however, that a higher standard must be met. This standard requires, among other things, a showing of a specific need for the information sought, its unavailability elsewhere, and a realistic expectation that the information is contained in the document sought. Applying this test to a situation closely analogous to that presented in this case, the Tenth Circuit held that the tax pool analysis was not relevant under section 7602.

The Fifth Circuit squarely rejected the Tenth Circuit's holding (App. 11a) in this case (as has the Second Circuit in *Arthur Young*, 677 F.2d at 218, and *United States v. Noall*, 587 F.2d 123 (1978), *cert. denied*, 441 U.S. 923 (1979)) leaving the law on the relevance question in a state of confusion. Because of these conflicts, the importance of the question, and the basic unfairness of providing the IRS unrestricted access to companies' documents in this situation, this Court should review the relevance issue.

CONCLUSION

The issues of law and public policy raised by this case are of deep and immediate concern to INGAA's member companies, as indeed they are to all public companies subject to the financial reporting requirements of the securities laws. The conflicting positions on these important issues have been crystallized in a series of circuit court decisions over the past decade and are now ready for re-

view by this Court. Further delay in their ultimate resolution is unlikely to lead to any further development of the issues, and will perpetuate the harmful uncertainty created by the conflict in the circuits. For these reasons the members of INGAA urge the Court to grant El Paso's Petition for a Writ of Certiorari on all issues.

Respectfully submitted,

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UNITED STATES OF AMERICA and CLARENCE H. ISBEL and JOHN S. REID, Revenue Agents of the Internal Revenue Service,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF AMICUS CURIAE OF MAIN HURDMAN IN SUPPORT OF THE PETITION FOR CERTIORARI

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Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF AMICUS CURIAE OF MAIN HURDMAN IN SUPPORT OF THE PETITION FOR CERTIORARI

Main Hurdman submits this brief as *amicus curiae*, pursuant to Rule 36.1 of the Rules of this Court, with the written consent of all parties.[1] Main Hurdman urges the Court to grant certiorari to decide both questions presented by the Petition.

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1 The Respondents' consent, in a letter from the Solicitor General dated November 10, 1982, and the Petitioner's consent, in a letter from E. Barrett Prettyman, Jr., dated November 12, 1982, are being filed together with this brief.

INTEREST OF MAIN HURDMAN AS AMICUS CURIAE

Main Hurdman is the ninth largest firm of certified public accountants in the United States, with over 500 partners in 80 offices throughout the country and additional offices abroad. Main Hurdman audits the financial statements of over 200 public corporations in the United States, including the Petitioner here. Main Hurdman has 12 offices and audits numerous clients within the Fifth Circuit.

The decision below, by allowing the Internal Revenue Service to have unfettered access to a company's so-called tax pool analysis and supporting memoranda in routine tax audits, directly affects, and seriously impedes, the ability of Main Hurdman and other certified public accountants to perform financial statement audits. If allowed to stand, the Fifth Circuit's decision will discourage corporations from preparing and from sharing with their auditors thorough and searching analyses of the strengths and weaknesses of positions taken on previously filed income tax returns that are likely to be challenged by the IRS because they involve tax issues in the "twilight zone" of the tax world. 682 F.2d at 534. This, in turn, will jeopardize the trustworthiness of audited financial statements by rendering reserves for contingent tax liabilities less accurate and more difficult to audit.

SUMMARY OF ARGUMENT

The questions presented by the Petition transcend in importance the dispute between the litigants about the specific tax pool analysis and back-up papers of The El Paso Company. Their resolution affects not only the El Paso Company and not just companies in the gas industry, but every publicly held company and every auditor of and investor in publicly held companies.

The Fifth Circuit's decision in this case announces three rules of law that advance the important public policy of tax

collection by facilitating the work of the Internal Revenue Service, but which frustrate other important public policies by seriously jeopardizing the accuracy of audited financial statements of publicly held corporations in all industries. First, the decision below holds that confidential tax pool analyses and back-up papers prepared by corporations and their lawyers and auditors—consisting of opinions, legal theories, and evaluations of anticipated disputes and litigation with the IRS about positions taken on previously filed income tax returns—are obtainable by the IRS under 26 U.S.C. § 7602 as a matter of routine, even where the taxpayer's state of mind is not in issue, as where fraud is being investigated. This ruling will necessarily make corporate taxpayers reluctant to commit candid and thorough contingent tax liability analyses to writing and also more cautious in sharing those analyses with their auditors. As the Second Circuit recently noted, *United States v. Arthur Young & Co.*, 677 F.2d 211, 220 (2d Cir. 1982), *petition for cert. filed*, No. 82-687 (Oct. 20, 1982):

> The prejudice involved in exposing to the Service appraisals of a taxpayer's weaknesses and settlement positions on audit is of such proportions that a prudent organization might not be perfectly candid with independent auditors once it knew that the information revealed would be reachable under § 7602.

This, in turn, will expose those who rely upon corporations' audited financial statements to "grave dangers of inaccuracy and untrustworthiness." *Hickman v. Taylor*, 329 U.S. 495, 513 (1947); *United States v. Arthur Young & Co.*, 677 F.2d at 221.

Second, the decision below holds that a corporation's confidential tax pool analysis and back-up papers that identify and evaluate potential IRS claims are not protected by the work product doctrine, in conflict with the Second Circuit decision in *United States v. Arthur Young & Co.*, 677 F.2d 211 (2d Cir. 1982), *petition for cert. filed*, No. 82-687 (Oct. 20, 1982). Work product protection is warranted because the need for a reserve for contingent tax liabilities and the tax pool analysis necessary

to compute an accurate reserve arises only because tax claims by the IRS are anticipated as being sufficiently probable to render them material.

Third, the decision below broadly holds that where an otherwise privileged opinion of a company's lawyer about anticipated tax claims by the Internal Revenue Service is discussed with or disclosed to the company's auditor, in confidence and for the auditor's evaluation, this constitutes an unconditional waiver of the attorney-client privilege. In so holding, the court below equates confidential communications between a company and its auditor with general dissemination to adversaries and strangers, notwithstanding that the communication with the auditor is for a limited purpose mandated by law and public policy and that the accounting profession imposes its own rule of confidentiality as stringent as that of the legal profession.[2] This broad holding by the Fifth Circuit affects not only tax pool analyses, but other opinions of the company's lawyers that may be necessary for auditors to use in evaluating the adequacy of financial statement treatment and disclosure of material litigation, claims, and contingent liabilities.

This Court should grant the Petition as to both questions presented to evaluate the wisdom of the rulings below that favor society's interest in the collection of revenues at the expense of the national public interest in reliable financial statements and fair markets in securities and at the expense of the policy favoring full and candid discussions between corporations, their attorneys, and their auditors. Because of the devastating effect that the order below will have on the auditing process and the accuracy of financial statements of public corporations, because of the cloud the decision below places on the confidentiality of discussions between corporations, their attorneys, and their auditors, because of the conflict between the rulings made by the Fifth Circuit and those of

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2 AICPA, *Rules of Conduct of the Code of Professional Ethics* Rule 301 (1981).

other circuits, and because the order below was based on incorrect perceptions of the applicable law, this Court should grant the Petition for Certiorari and, upon review, reverse the Fifth Circuit's decision.

ARGUMENT

I. Certiorari Should Be Granted To Consider Whether Tax Pool Analyses Should Be Routinely Obtainable by the Internal Revenue Service Under 26 U.S.C. § 7602

The decision below holds that confidential tax pool analyses and back-up papers are relevant documents routinely obtainable by the Internal Revenue Service under 26 U.S.C. § 7602. This decision conflicts explicitly with the decision of the Tenth Circuit in *United States v. Coopers & Lybrand*, 550 F.2d 615 (10th Cir. 1977), conflicts implicitly with the Eighth Circuit's decision in *United States v. Matras*, 487 F.2d 1271 (8th Cir. 1973), and, in a different respect, conflicts with the decision of the Second Circuit in *United States v. Arthur Young & Co.*, 677 F.2d 211 (2d Cir. 1982), *petition for cert. filed*, No. 82-687 (Oct. 20, 1982).[3]

A. The Importance of Tax Pool Analyses

A material item on practically every publicly held corporation's financial statement is the provision for income taxes. This provision consists of two parts: First, taxes that the corporation acknowledges are owed as reported on its tax returns and which it has paid or will pay when due; second, a reserve for contingent tax liability that ultimately may be due after the corporation's tax returns are audited by the Internal Revenue Service and all disputed items have ultimately been resolved through litigation or settled in negotiation. To arrive

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3 Until the decision below, each court of appeals that had considered the question had denied the IRS access to confidential tax pool analyses, albeit upon conflicting rationales. An analysis of the conflict among the circuits is set forth in the Petition for Certiorari at 11-16 and will not be repeated here.

at and support the amount of the reserve for contingent tax liability, those who advise the corporation on tax matters—which may be any combination of financial and accounting management, in-house and outside tax counsel, and in-house and outside tax accountants—prepare an analysis that is known by various terms, but commonly called the tax pool analysis. The court below found that the tax pool analysis in this case consists of a "four to five page list of the items believed to be vulnerable to challenge." 682 F.2d at 536.

For each item as to which a challenge is anticipated, the tax pool analysis gives consideration to such issues as the tax advisors' opinions of the merits of the tax issue, the dollar amount involved, the estimated cost of litigation, legal theories that the taxpayer and the IRS might advance in support of their respective positions, opinions as to the probable outcome of the potentially disputed items if litigated in the various forums available, and whether the corporation would be disposed to settle the dispute with the IRS and, if so, for what amount. Based upon this analysis, the corporation's management estimates the amount of the corporation's contingent tax liability and includes a reserve for it in the financial statements. It is the task of the auditor to assess this reserve as part of the audit process,[4] taking into account all of the information available as to how and on what basis it was computed and making his own tax pool analysis as well.

Although the Internal Revenue Service has had statutory power to summon all relevant and material evidence for over 56 years,[5] it has only recently perceived a need for the tax-

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4 AICPA, *Codification of Statements on Auditing Standards* § 110 (1982); Note, *Government Access to Corporate Documents and Auditors' Workpapers: Should We Include Auditors Among the Privileged Few?*, 2 J. Corp. L. 349, 357 (1977).

5 *See* Act of Feb. 26, 1926, ch. 27, §§ 1104(a), 1105(a), 44 Stat. 113, 118 (formerly codified as amended at Internal Revenue Code of 1939 §§ 3614(a), 3615(a)).

payer's own analyses. 682 F.2d at 547 (dissenting opinion below). The IRS's efforts to obtain these analyses have caused a storm of protest by knowledgeable commentators[6] and, until the decision below, have been rejected by every court of appeals that has considered them.[7]

The decision below, by making the self-searching tax pool analysis routinely available to the corporation's principal tax adversary, likely will lead corporations and their tax advisors to disclose as little as possible in their written tax pool analysis and back-up. It also will cause the corporate taxpayer to abbreviate discussion of anticipated tax litigation as much as possible and will drive a wedge between auditors and their clients. *See* Petition for Certiorari at 18-21 and authorities cited therein; *cf. Hickman v. Taylor,* 329 U.S. 495, 511 (1947) ("much of what is now put down in writing would remain unwritten").

Although corporations would prepare and supply auditors with the necessary[8] minimum to enable the auditor to issue a "clean" opinion, the Fifth Circuit's rule will reduce the reliability of the reserves for contingent tax liability reflected on financial statements and make it more difficult for auditors, in

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6 Note, *Government Access to Corporate Documents and Auditors Workpapers: Shall We Include Auditors Among the Privileged Few?,* 2 J. Corp. L. 349 (1977); Hanson & Brown, *CPA's Workpapers: The IRS Zeroes In,* 152 J. Accountancy 68 (1981); Kurtz, *Discussion on "Questionable Positions,"* 32 Tax Law. 13 (1978); Caplin, *Should the Service Be Permitted To Reach Accountants' Tax Accrual Workpapers?,* 51 J. Tax'n 194 (1979).

7 *United States v. Arthur Young & Co.,* 677 F.2d 211 (2d Cir. 1982), *petition for cert. filed,* No. 82-687 (Oct. 20, 1982); *United States v. Coopers & Lybrand,* 550 F.2d 615 (10th Cir. 1977); *cf. United States v. Matras,* 487 F.2d 1271 (8th Cir. 1973).

8 Securities Exchange Act of 1934 § 12, 15 U.S.C. § 78*l*; Regulation S-X, 17 C.F.R. pt. 210. Accruals for unpaid taxes are an integral component of the financial statements required to be filed by registrants with the Securities and Exchange Commission and must be analyzed by the auditor. AICPA, *Codification of Statements on Auditing Standards* §§ 328, 337, 509 (1982).

the public interest, to examine the adequacy of those reserves. Before the balance between the competing interests involved is tipped in favor of aiding the IRS' tax collection efforts, this Court should evaluate the conflicting values and interests that have led other circuits to different conclusions.

B. Tax Pool Analyses Should Not Be Deemed Relevant in a Routine Audit

As the Solicitor General avers with respect to the issue of whether tax pool analyses should be protected by a work product privilege, the issue of whether tax pool analyses should be routinely obtainable by the IRS as relevant under 26 U.S.C. § 7602 "is of major importance to the administration and enforcement of the revenue laws, and to the accounting and legal professions." Petition for Certiorari at 7, *United States v. Arthur Young & Co.*, No. 82-687 (filed Oct. 20, 1982). We agree with the Solicitor General when he states: "This Court should grant certiorari and establish a uniform national rule with respect to the production of such tax accrual workpapers." *Id.*

As this Court has recognized, the Internal Revenue Service has broad power under 26 U.S.C. § 7602 to obtain relevant factual materials pertaining to the determination of tax liability. *E.g., United States v. Bisceglia,* 420 U.S. 141 (1975); *United States v. Powell,* 379 U.S. 48 (1964). However, the tax pool analysis that the IRS is now seeking in corporate audits reveals no facts concerning the taxpayer's tax liability or the transactions giving rise to tax liability that are not already available to the IRS. As the court below acknowledged, the tax pool analysis is not made in the course of preparing the company's tax returns, nor is it a source of the information used in the tax returns or evidence of the company's underlying transactions. 682 F.2d at 537.

The IRS's recently discovered need for tax pool analyses derives solely from its desire to have the corporation's own tax advisors do some of the IRS's thinking for it. The IRS seeks

not facts, but rather the thoughts, opinions, and legal theories of corporate taxpayers and their advisors even where there is no issue to which they might be relevant, such as fraud or the taxpayer's good faith, and solely as a shortcut in the IRS's own analysis—in the words of the court below, to "focus and concentrate the Service's energy." 682 F.2d at 537.[9]

This Court should resolve the question of whether, as the Fifth Circuit ruled below, this is sufficient to satisfy the relevance requirement of 26 U.S.C. § 7602 or whether, as the Tenth Circuit held in *United States v. Coopers & Lybrand*, 550 F.2d 615 (10th Cir. 1977), the tax pool analysis and back-up materials are not relevant materials subject to IRS summons.

C. Tax Pool Analyses and Supporting Work Papers Should Be Protected as Work Product

Fed. R. Civ. P. 81(a)(3) makes the work product doctrine codified in Fed. R. Civ. P. 26(b)(3) applicable to proceedings for enforcement of IRS summonses under 26 U.S.C. § 7602. *Upjohn Co. v. United States*, 449 U.S. 383, 398 (1981). In *United States v. Arthur Young & Co.*, 677 F.2d 211 (2d Cir. 1982), *petition for cert. filed*, No. 82-687 (Oct. 20, 1982), the Second Circuit concluded that the tax pool analysis work papers of outside auditors constitute a form of work product that must be protected from disclosure to the IRS because "the integrity of the [independent] auditing process," *id.* at 221, depends upon management feeling free to be frank and open with their auditors with respect to debatable positions taken on the corporate tax returns that are subject to IRS challenge. *Id.* at 219-20. The Solicitor General acknowledges that the Fifth Circuit decision below, in rejecting work product protection for El Paso's tax pool analysis and back-up papers, is in

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9 To paraphrase this Court's recent observation, 26 U.S.C. § 7602 "was hardly intended to enable [the IRS] to perform its functions . . . on wits borrowed from the adversary." *Upjohn Co. v. United States*, 449 U.S. 383, 396 (1981) (quoting *Hickman v. Taylor*, 329 U.S. 495, 516 (1947) (Jackson, J., concurring)).

conflict with the Second Circuit decision and states that the issue of whether such papers are protected from disclosure as work product "is of major importance to the administration of the revenue laws, and to the accounting and legal professions." Petition for Certiorari at 6-7, *United States v. Arthur Young & Co.*, No. 80-687 (filed Oct. 20, 1982).

The majority below reasons that work product protection is not applicable because "the tax pool analysis is not prepared in 'anticipation of litigation,' " 682 F.2d at 542, but rather

> is "[p]repared for financial reporting purposes alone. . . ." Caplin, *IRS Toughens Its Stance on Summoning Accountant's Tax Accrual Workpapers*, J. Tax 130 (Sept. 1980). While the analysis must forecast the cumulative results of IRS audit, settlement, and litigation, the tax pool analysis itself is not prepared to respond to a specific charge by the IRS or to any pending or impending lawsuit. The tax pool analysis is undertaken solely to insure that the corporation sets aside on its balance sheet a sufficient amount to cover contingent tax liability.

682 F.2d at 535.

This reasoning obscures the essence of the tax pool analysis: it must be performed *solely* because tax litigation with the IRS is anticipated. Absent the material threat of IRS claims enforceable by litigation, there would be no need for tax pool analyses for *any* purpose, accounting or otherwise. The likelihood of IRS claims and litigation results not because of any wrongdoing by corporate taxpayers, but because "[t]here are many 'gray areas' in the tax world, twilight zones in which one may only dimly perceive how properly to treat a given accretion to wealth or given expenditure of funds." 682 F.2d at 534.

Therefore, the majority below is mistaken in suggesting that the tax pool analysis is undertaken primarily for financial reporting purposes that are "distant from actual litigation." 682 F.2d at 543. Were it not for the likelihood of tax litigation over the "gray areas" and "twilight zones" in the tax world,

neither the rules of the Securities and Exchange Commission, nor accounting principles, nor auditing standards would require a tax pool analysis to be done. So, it is the fact that litigation is anticipated that spawns the tax pool analysis. From the point of view of auditors, investors, and all those who use financial statements, including company management, it is vital to have a tax pool analysis that is as searching, comprehensive, and frank as possible to determine and review the adequacy of the reserve for contingent tax liabilities—without fear that this analysis will, in the hands of the IRS, be a tool against the company in the anticipated litigation.

The mental processes and analyses which are revealed by tax pool analysis workpapers are at the very core of the protection afforded by the work product doctrine. Even where a party seeking to discover work product materials has satisfied the rigorous standard of showing substantial need and undue hardship, courts nevertheless are enjoined to "protect against disclosure of the mental impressions, conclusions, opinions, or legal theories of an attorney or their representative of a party concerning the litigation." Fed. R. Civ. P. 26(b)(3); *Upjohn Co. v. United States,* 449 U.S. 383, 399-401 (1981).

The court below passed over these considerations. Nor did it appear to seriously weigh the impact of its decision on audits of reserves for contingent liability for tax and other litigation. Without fairly weighing the conflicting policies involved, the court below simply concluded that society's interest in tax collection is sufficient to require disclosure of a corporation's and its auditor's analyses, legal theories, settlement positions, and opinions about anticipated IRS claims. This Court should grant certiorari to resolve the conflict between the policies involved and to establish a balanced rule that does not frustrate communication between auditors and their clients in evaluating anticipated tax claims.

II. Certiorari Should Be Granted To Consider Whether Confidential Discussion of Privileged Attorney-Client Communications with an Auditor Waives the Privilege

The decision below broadly holds that any discussion between a company and its auditor, or any disclosure to a company's auditor, of privileged communications with the company's lawyers or opinions of the company's lawyers constitutes a waiver of the attorney-client privilege—not only as to the particular items discussed with or disclosed to the auditor, but also as to any other privileged communications dealing with the same subject. The sweeping theory of waiver of privilege adopted by the Fifth Circuit below is not confined to tax pool analyses. It is in conflict with decisions of the Sixth, Eighth, and Ninth Circuits.[10] *See* Petition for Certiorari at 16-17 & n.10. It threatens to cut off or seriously dilute the flow of information to auditors that is essential for auditors to perform their responsibilities in assuring the reliability of financial statements.

In view of the important public policies served by the auditing of financial statements and the important public policies promoted by the attorney-client privilege, *Upjohn Co. v. United States*, 449 U.S. 383, 389-90 (1981), certiorari should be granted to resolve the uncertainties surrounding the privilege which the court below created. As this Court recently observed in *Upjohn*:

> [I]f the purpose of the attorney-client privilege is to be served, the attorney and client must be able to predict with some degree of certainty whether particular discussions will be protected. An uncertain privilege, or one which purports to be certain but results in widely varying

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10 *United States v. Upjohn*, 600 F.2d 1223 (6th Cir. 1979), *rev'd on other grounds*, 449 U.S. 383 (1981); *Diversified Industries, Inc. v. Meredith*, 572 F.2d 596 (8th Cir. 1977) (en banc); *United States v. Cote*, 456 F.2d 142 (8th Cir. 1972); *Weil v. Investment/Indicators, Research & Management*, 647 F.2d 18 (9th Cir. 1981).

> applications by the courts, is little better than no privilege at all.

Id. at 393. And:

> [B]ecause Federal Rule of Evidence 501 provides that the law of privileges "shall be governed by the principles of the common law as they may be interpreted by the courts of the United States in light of reason and experience," this Court has a special duty to clarify aspects of the law of privileges properly before us.

Id. at 403-04 (Burger, C.J., concurring in part).

A. The Sweeping Waiver of Privilege Doctrine Adopted Below Impairs the Audit Process

The broad waiver rule announced below profoundly, and adversely, affects the profession of public accountancy and the public interest served by that profession. Certified public accountants, in the course of auditing financial statements, frequently require access to privileged attorney-client materials in order to assess, among other things, the adequacy of a company's financial statement disclosure of material litigation, threatened or asserted claims, legal risks, and other contingencies, as well as the adequacy of reserves provided for these contingencies. If the rule adopted below is followed, continuing to make these privileged materials available to auditors would render them, together with all other attorney-client communications on the same subject, unprivileged. All of these attorney-client communications would then become generally available—not only to the IRS, as in this case, but also to any private party in civil litigation and to any government agency in litigation or administrative proceedings.

This would work an almost total abrogation of a corporation's attorney-client privilege as we know it, contrary to the important policies articulated by this Court in *Upjohn Co. v. United States*, 449 U.S. 383 (1981). Rather than incur this intolerable result, the corporation's only alternative would be

to deny its auditors access to privileged attorney-client communications. This would work to the detriment of the audit process and, ultimately, to the detriment of all who rely upon audited financial statements.

The waiver doctrine adopted below also appears to prejudge an important issue that was not before the court: whether the opinions of counsel regularly furnished in response to auditors' requests for information concerning litigation, claims, and loss contingencies are privileged.[11] It is our understanding that there have been no reported decisions dealing with this important question. We are aware of three unreported lower court rulings that have denied discovery of opinion letters of counsel. *In re Cessna Aircraft Distributorship Antitrust Litigation,* M.D.L. No. 123 (D. Kan. Sept. 18, 1980); *International Business Machines Corp. v. Catamore Enterprises, Inc.*, C.A. No. 5030 (D.R.I. Mar. 19, 1975) ("the 'legal letters and related materials' . . . are of a confidential nature and need not be produced"); *Teberg v. American Pacific International, Inc.*, No. C. 196448 (Cal. Super. Ct. Apr. 19, 1982) ("the relevance of [lawyers' opinion letters] is outweighed by the public policy of promoting candid and full disclosure by counsel to independent accountants or auditors during the audit process and the right of privacy"). We know of no decisions ordering discovery of lawyers' opinion letters to auditors.

B. The Waiver Doctrine Adopted Below Ignores the Confidentiality of Client-Auditor Communications

The waiver doctrine announced below is based upon the false premise that a client's communications with certified public accountants are not, and are not expected to be, confidential. 682 F.2d at 540. From this faulty premise, the majority reasons that discussion of privileged matter with an auditor ends the confidentiality requisite for the continued existence of the attorney-client privilege.

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11 *See generally* AICPA, *Codification of Statements on Auditing Standards* § 337 (1982); ABA, *Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information* (1975).

We submit that the court below erred in equating client-auditor communications with the disclosure of information to strangers or adversaries. Its ruling ignores the fact that the profession of certified public accountancy is bound by a rule of confidentiality as stringent as that imposed upon the legal profession. AICPA, *Rules of Conduct of the Code of Professional Ethics* Rule 301 (1981) provides: "A member shall not disclose any confidential information obtained in the course of a professional engagement except with the consent of the client."[12] In the case of tax pool analyses, the IRS itself recognizes that they are communicated by the client *in confidence* to the auditor. I Internal Revenue Manual (Audit) (CCH) § 232.8(4) (May 1982).

The authorities cited by the majority in support of finding the privilege waived, 682 F.2d at 538-39, all involved disclosures of privileged matter to strangers, opponents, or the public generally: *Permian Corp. v. United States,* 665 F.2d 1214, 1219 (D.C. Cir. 1981) (disclosure to SEC); *United States v. Miller,* 660 F.2d 563, 567-68 (5th Cir. 1981) (disclosure to IRS); *United States v. Davis,* 636 F.2d 1028, 1043 n.18 (5th Cir. 1981) (same); *Green v. Crapo,* 181 Mass. 55, 62, 62 N.E. 956, 959 (1902) (public testimony); McCormick, *Evidence* § 93 (E. Cleary 2d ed. 1972) (public testimony). None held that a disclosure limited to a professional engaged by the client and bound to hold the matter *in confidence* destroyed the element of confidentiality.

In finding a waiver, the opinion below also emphasizes that thus far the law has not recognized an evidentiary privilege for client-accountant communications. 682 F.2d at 530-31. But the question here is not whether client-accountant communications are privileged in themselves. Rather, the question is whether sharing a concededly privileged attorney-client communication with an auditor *bound to retain that communication in confidence* renders the attorney-client communication not confidential and thus abrogates the privilege.

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12 Rule 301 goes on to provide that the rule does not affect the accountant's legal obligation to comply with valid judicial process.

C. The Waiver Doctrine Adopted Below Threatens To Abrogate the Attorney-Client Privilege for Corporations

In *Upjohn Co. v. United States*, 149 U.S. 383 (1981), this Court recognized the need to accommodate the requirements of the attorney-client privilege to the reality of corporate life. As Judge Garwood explained in dissent below, 682 F.2d at 551:

> The reality of the matter is that for publicly held companies very little information can properly be held entirely confidential from independent auditors. If we do not take these realities into account in developing and applying theories of waiver of the attorney-client privilege in these situations, there is a substantial danger that the attorney-client privilege for publicly held corporations, so recently reaffirmed in *Upjohn Co. v. United States* [citation] will become nothing but an empty theory.

Another practical reality is the need for companies faced with the threat of claims and litigation by the IRS to draw upon their accountants' expertise as part of the process of obtaining their lawyers' opinion as to potential areas of dispute, the legal theories that each side might advance, and the probable outcome. *Cf. United States v. Kovel*, 296 F.2d 918 (2d Cir. 1961) (Friendly, J.), which recognized that where an accountant participates in attorney-client communications for the purpose of assisting the lawyer in rendering legal services in tax matters, the accountant's participation does not abrogate the attorney-client privilege. *Id.* at 922. Indeed, Judge Friendly opined that the attorney-client privilege would attach to a communication directly between the client and the accountant, if its purpose was to assist the lawyer in counseling the client. *Id.* at 919, 921-23.

This Court itself should weigh the benefits of protecting attorney-client communications when shared with an auditor in the audit process before such protection is jettisoned in the interest of facilitating tax collection.

CONCLUSION

For the reasons stated, the Petition for a Writ of Certiorari should be granted.

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No. 82-716

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

THE EL PASO COMPANY,
Petitioner,

v.

UNITED STATES OF AMERICA, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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BRIEF OF THE NATIONAL ASSOCIATION OF MANUFACTURERS AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

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BRIEF OF THE NATIONAL ASSOCIATION OF MANUFACTURERS AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

INTEREST OF AMICUS CURIAE

With the consent of all the parties, the National Association of Manufacturers (NAM) files this brief in support of the Petitioner. The NAM is a non-profit voluntary business association incorporated under the laws of the State of New York NAM has a membership of approximately 12,000 manufacturing and related business concerns which, in the aggregate, produce an estimated 80 percent of all goods manufactured in the United States.

As for-profit corporations, all of NAM's corporate members file tax returns and are, therefore, subject to periodic audit by the Internal Revenue Service (IRS). Members of the NAM try to cooperate with the IRS in these audits and are usually willing to provide all requested information that is relevant to the IRS audit. In addition, since many NAM members are publicly held entities, they are also subject to the various rules and regulations, as well as the statutes, administered and enforced by the Securities and Exchange Commission (SEC).

NAM members, like most corporations and many individuals, employ or retain professionals with expertise in a variety of fields for the purpose of assuring compliance with these complex laws. In the case at bar, in-house counsel directed and assisted in the preparation of the Petitioner's tax pool analysis, from which certain data were discussed with its retained independent auditors who, in turn, reviewed Petitioner's financial statements as required by the SEC. Despite the fact that this analysis was neither prepared for nor used in connection with the preparation of Petitioner's tax return, the court deemed this information to be "relevant" within the meaning of 26 U.S.C. § 7602. Furthermore, Petitioner's limited discussion of certain data relating to this analysis with the independent auditors led the court below to determine that the attorney-client privilege was waived as to the entire tax pool analysis being requested by the IRS in connection with the tax audit.

The weakening of the relevancy requirement of § 7602 and the erosion of the attorney-client privilege that the decision of the court below has caused are serious issues that deserve the scrutiny of this Court. Further, the fact that the holding below allows the IRS to freely review virtually any corporate document, regardless of its pertinence to a tax return, with little more than a bald assertion that it might "throw light" on the return, creates

the potential for a great deal of mischief and unwarranted "fishing expeditions" through corporate files.

The potential breadth of this decision in its impact throughout American industry and the fact that it penalizes good faith corporate efforts to comply with complex federal laws with an involuntary waiver of the attorney-client privilege could have a profound effect on the membership of the NAM. Offering this broad base of representation, we believe that we can present this Court with a perspective beyond that which is represented by the Petitioner.

SUMMARY OF THE CASE

On February 13, 1980, the IRS issued a summons pursuant to 26 U.S.C. § 7602 to the Petitioner, The El Paso Company, in connection with a routine examination of the company's tax returns for the years 1976 through 1978. Among other things, the summons requested the production of documents, memoranda, letters, or work papers which identified and discussed potential tax liabilities or tax problems for the period beginning January 1, 1976 through December 31, 1978. The principal purpose of the summons was to obtain El Paso's tax pool analysis even though the analysis was not used in El Paso's preparation of its tax returns for the years in question.

The Petitioner declined to comply with the summons on the grounds that the documents sought were not relevant or material to any legitimate IRS inquiry and that they were, in any case, privileged. On May 27, 1981, the IRS filed a petition for the enforcement of its summons in the United States District Court for the Southern District of Texas. El Paso maintained that the summons was overbroad, that the documents were not relevant to any legitimate investigatory purpose of the IRS, and that they were protected by the attorney-client and/or

work-product privileges. The District Court rejected these contentions, adopting instead the findings of fact and conclusions of law prepared by the government without change.

A divided Court of Appeals for the Fifth Circuit affirmed the judgment of the District Court on August 13, 1982. While narrowing the permissible scope of the summons somewhat, the appellate court held that the tax pool analysis was "relevant" within the meaning of 26 U.S.C. § 7602, despite a contrary holding by the Tenth Circuit in *United States v. Coopers and Lybrand*, 550 F.2d 615 (10th Cir. 1977). The court concluded that this material might be useful to the IRS as a "road map" through El Paso's tax returns.

The Court of Appeals also refused to classify the tax pool analysis as privileged information since it was not, in its judgment, prepared in anticipation of litigation and since certain items contained therein were discussed with the Petitioner's independent auditors.[1]

SUMMARY OF THE ARGUMENT

The decision of the court below underscores and widens a split among the circuits as to the quantum of evidence the IRS must produce in order to demonstrate that a piece of information is "relevant" to a tax audit and therefore subject to examination pursuant to 26 U.S.C. § 7602. The guidance of this Court is required to give substance to the relevancy requirements it enunciated in *United States v. Powell*, 379 U.S. 48 (1964).

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[1] The court did acknowledge that this portion of its holding was at variance with a decision rendered by the Second Circuit in *United States v. Arthur Young and Co.*, 677 F.2d 211 (2d Cir. 1982), *petition for cert. filed*, No. 82-687 (Oct. 20, 1982). This issue is fully discussed in El Paso's petition at 14-16, 18-21.

This decision penalizes the Petitioner, and potentially other similarly situated corporations, for their efforts to comply with a variety of complex federal laws. In this case, the Petitioner's attorneys directed the preparation of a tax pool analysis analyzing the possibility of future potential tax liabilities and any litigation or negotiation that might occur with the IRS over same. The preparation of a tax pool analysis is common in publicly held corporations. This material was not used in the preparation of the tax returns that were the subject of the tax audit here. The drafting and preparation of the financial statements required by the SEC mandate that the independent auditors of the Petitioner receive certain information that is contained in the tax pool analysis. Such information was received in discussions with the Petitioner's counsel, but at no time were the tax pool analysis documents ever shown to the independent auditors. This process, required both by generally accepted accounting principles and SEC regulations, led the court below to declare that the Petitioners had, in effect, waived the attorney-client privilege as to all documents contained in the tax pool analysis despite contrary lines of authority in other circuits. *United States v. Upjohn*, 600 F.2d 1223 (6th Cir. 1979), *rev'd on other grounds*, 449 U.S. 383 (1981); *see Diversified Industries, Inc. v. Meredith*, 572 F.2d 596 (8th Cir. 1977) (en banc).

Ignoring these clear lines of authority, and going beyond the spirit of the law as enunciated by this Court in *Powell*, the court below deemed the relevancy requirement of § 7602 satisfied if the requested documents "might throw light upon" the tax returns of the Petitioner. This very low threshold of proof is at variance with that required by other circuits.

These erroneous conclusions and the split in authority at the appellate level merit consideration of this case by the Supreme Court.

ARGUMENT

I. THE STANDARD OF RELEVANCE UNDER 26 U.S.C. § 7602 REQUIRES A FINAL DETERMINATION BY THIS COURT

Few in the corporate community or elsewhere would dispute the IRS' need for authority to examine the books, records, papers, etc., of a taxpayer in order to ascertain the correctness of a tax return. Indeed, such powers of examination in connection with an audit have been granted to the IRS under 26 U.S.C. § 7602. However, these broad investigatory powers are expressly limited to information that meets a threshold test of relevance. Thus, the statute itself empowers the IRS only to "examine any books, papers, records, or other data which *may be relevant* [to the examination of a tax return]." 26 U.S.C. § 7602 (emphasis supplied).

The determination of exactly what is relevant under this code provision requires a balancing of the IRS' need for records that will accurately reflect upon the correctness of a particular tax return against the right of a taxpayer to retain some degree of confidentiality and control over his files. Thus in *United States v. Powell*, 379 U.S. 48 (1964), this Court determined that an exercise of the summons power conferred upon the IRS by this section must comport with several factors, namely, "that the investigation will be conducted pursuant to a legitimate purpose, that the inquiry may be relevant to [that] purpose, that the information sought is not already within the Commissioner's possession . . . ." 379 U.S. at 57-58. Although useful in delineating the boundaries of the relevance analysis and inquiry, *Powell* does little to define its content, particularly in a matter like the case at bar.

The records at issue here are those that comprise the Petitioner's "tax pool analysis." Simply stated, a tax pool analysis serves to identify issues on a company's tax return which its counsel believe might be questioned

or challenged by the IRS. It also speculates on the likelihood of IRS action on the return, and attempts to estimate and assign a total cost for these issues if they are settled or litigated. Here, this document was prepared at the direction of, and in consultation with, El Paso's in-house counsel and was not used in the preparation of the tax returns in question. Instead, the tax pool analysis was used for purposes completely unrelated to tax return preparation. More specifically, this analysis was generated in an effort to comply with good accounting practices and various requirements of the federal securities laws.

The SEC requires public corporations subject to its jurisdiction periodically to file audited financial statements. *See* 15 U.S.C. § 78*l*, 17 C.F.R. § 210 *et seq.* These statements must be prepared in accordance with "generally accepted accounting principles" which, in turn, require the disclosure of what are termed "material contingent liabilities." *See* American Institute of Certified Public Accountants, Statement on Auditing Standards No. 1, § 110.01 (1973). Since income tax liability is certainly important in determining the eventual net income of a corporation, additional tax assessments and the probability that they will be imposed are considered to be "material contingent liabilities" under these accepted accounting principles. Thus, certain of the elements contained in the tax pool analysis, prepared herein with the assistance of in-house counsel, were considered by the independent auditors in preparing the financial statements required by the SEC.

In rejecting the request of the IRS for the tax pool analysis on grounds of relevance, the Petitioner noted that the tax pool analysis was not used to prepare its tax returns. This fact was recognized by the lower court, since a tax pool analysis contains little more than private thoughts, theories, and speculations as regards the company's tax returns. ***United States v. The El Paso***

Company, 682 F.2d 530, 535 (5th Cir. 1982). For this and other reasons, a tax pool analysis was held not to be relevant to an IRS audit in *United States v. Coopers and Lybrand*, 550 F.2d 615 (10th Cir. 1977). The test that must be used in a relevance analysis, according to the court in *Coopers and Lybrand*, is a balancing test consisting of factors such as whether the information sought consisted of facts or opinions, whether it was prepared in connection with the tax return in question, whether the IRS could conduct the audit with the facts it had, and whether the IRS had demonstrated a specific need for the information sought rather than mere convenience. *Id.* at 621. *See also* Note, *A Balancing Approach to the Discoverability of Accountants' Tax Liability Workpapers Under Section 7602 of the Internal Revenue Code*, 60 Wash. U.L.Q. 185, 203 (1982). Buttressing this approach is the earlier decision of the Eighth Circuit in *United States v. Matras*, 487 F.2d 1271 (8th Cir. 1973), where the court held that only records of actual transactions were relevant to a determination of tax liability, *id.* at 1275; anything else was held not to be relevant under § 7602. Interestingly, the circuit court in *Matras* held that relevance must be construed to connote something more than mere convenience, rejecting a relevance standard based on a document's utility as a potential "road map" through a tax return. *Id.* This approach, rejected in *Matras*, was implicitly adopted by the court below. *See* 682 F.2d at 545.

A split among the circuits in this area developed in 1978 with the decision in *United States v. Noall*, 587 F.2d 123 (2d Cir. 1978), *cert. denied*, 441 U.S. 923 (1979) and widened in *United States v. Arthur Young and Co.*, 677 F.2d 211 (2d Cir. 1982), *petition for cert. filed*, No. 82-687 (Oct. 20, 1982). In these decisions, the reasoning of *Coopers and Lybrand* was rejected. In *Arthur Young*, the Second Circuit established a much lower threshold of relevance for determining the propriety of an IRS request for information under § 7602.

Spurning the balancing test of *Coopers and Lybrand*, the *Arthur Young* court declared that if the information sought "might have thrown light upon" the correctness of the return, the information requested would be deemed to be relevant under § 7602. *Arthur Young*, 677 F.2d at 218.[2]

In the proceedings below, the Fifth Circuit rejected the reasoning of *Coopers and Lybrand*, and by implication, *Matras*, and held that El Paso's tax pool analysis and related materials were relevant to an IRS audit of its 1976 through 1978 tax returns. The result is further confusion and conflict regarding the relevance standard: in the Fifth and Second Circuits, the tax pool analysis is deemed to be relevant and subject to production in a tax audit, while in the Tenth and Eighth Circuits it would not be.

The preparation of a tax pool analysis and its accompanying materials is widespread in American corporations; indeed, such an analysis is a necessary ingredient in the preparation of required financial statements. Corporations, while generally willing to allow reasonable access to documents that are germane to the preparation of their tax returns, contend that something more than an idle hope that a document will reveal a tax liability must be shown in order to compel its production. *See United States v. Coopers and Lybrand*, 413 F. Supp. 942, 949-54 (D. Colo. 1975). The Fifth Circuit, in rejecting the balancing test enunciated in *Coopers and Lybrand*, has given license to unlimited fishing expeditions through corporate files on the basis of little more than this "idle hope" that an examination of any document related to corporate finances—whether used in tax return preparation or not—will lead to a finding of additional tax liability. Under this "conveni-

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[2] Despite this, the Second Circuit also held that such information (in this case a tax pool analysis) was privileged, and therefore not discoverable under § 7602. 677 F.2d at 219.

ence" standard fashioned by the Fifth Circuit here, it is difficult to imagine any corporate document that the IRS could not deem relevant should it so desire. *See United States v. Matras*, 487 F.2d 1271, 1275 (8th Cir. 1973). It is doubtful that this was the intent of Congress in its passage of § 7602.

Finally, the decision of the court below here leads to the rather unfortunate result that separate independent operating entities of the same corporation could be subject to different standards of relevance for the production of records under the same statute, the Internal Revenue Code, depending upon the Circuit in which they happen to be located. The criteria for discovery under the tax laws should apply uniformly, just as its more substantive portions do. As such, this issue is worthy of review by this Court.

II. THE DECISION OF THE COURT OF APPEALS ERODES THE ATTORNEY-CLIENT PRIVILEGE

The attorney-client privilege is the oldest of the privileges recognized by law. The privilege is a fundamental principle in the relationship between the lawyer and client. Its purpose is to encourage full and frank communication in the hope that, in so doing, sound legal advice will be given and justice will be served. In the final draft of its proposed Model Rules of Professional Conduct, the American Bar Association has stated that the privilege "applies not merely to matters communicated in confidence by the client, but also to *all information relating to the representation*, whatever its source." *ABA Model Rules of Professional Conduct*, Rule 1.6. (Final Draft) (emphasis supplied).

The information sought by the IRS was prepared under the direction of, and in consultation with, the legal staff of El Paso and included its thoughts and opinions on the company's potential future tax liability, as well

as its opinion as to the probable outcome of litigation or negotiation based thereon. It should be emphasized that these matters consisted of opinions, not facts, and were not used by the Petitioner in the preparation of the tax returns that were the subject of the audit. The information at issue here was nothing more than speculation and opinion prepared to enable the Petitioner's tax advisers and in-house counsel to give sound advice on an issue of importance to the client.

Thusly characterized, the tax pool analysis would surely seem to be privileged information under the broad rubric of the attorney-client privilege. Indeed, even the Fifth Circuit below, while denying confidential treatment to those materials noted that the "purpose of the attorney-client privilege is to promote the flow of information to the attorney to enable him to give informed legal advice." *United States v. The El Paso Company*, 682 F.2d 530, 538 n.8 (5th Cir. 1982) (citing *Upjohn v. United States*, 449 U.S. 383 (1982)).

This is precisely one of the reasons that the tax pool analysis was done in the case at bar: to enable counsel to give his corporate client "informed legal advice" on the potential for future tax problems. Thus, by its own hand, the court below indicates that information of the type at issue here should be privileged. However, the Fifth Circuit deemed the privilege waived as to these documents since the Petitioner's counsel discussed some of the information regarding potential tax liability issues contained in the tax pool analysis with the independent auditors who certified the corporation's books pursuant to requirements of the SEC.

These discussions with the auditors were not optional or voluntary. Rather, a disclosure or discussion of certain of the issues contained in the tax pool analysis to independent auditors is necessary under the generally accepted standards of accounting mandated for corporate auditors who prepare the financial statements pur-

suant to the various federal securities laws. *E.g.*, 15 U.S.C. § 78*l*, 17 C.F.R. § 210 *et seq.* Such a disclosure would not be held to waive the attorney-client privilege as to the IRS under *Diversified Industries, Inc. v. Meredith*, 572 F.2d 596 (8th Cir. 1977) (en banc). Thus, this ruling not only conflicts with other authority, but results in a complete and involuntary waiver of the attorney-client privilege when a partial disclosure of otherwise privileged information is made to an accountant retained by the same client where such a disclosure is compelled by an effort to comply with federal law. This waiver occurs even if, as in this case, the rationale for the disclosure request under § 7602 is totally unrelated to that of the initial, partial communication of privileged information. Further, under the holding of the court below, the waiver extends not only to the disclosed information, but to the entire body of data from which the disclosed information was derived.

That this holding ignores and conflicts with other authority is reason enough for this Court to review the decision of the court below. Equally important, however, is the likelihood that the decision below, if allowed to stand, will do serious damage to other significant governmental goals. For example, a frequently acknowledged goal of the various federal securities laws is to foster public confidence in the securities markets. The principal means used to accomplish this aim is the required disclosure of all material facts regarding the health of a company. Of course, contingent liabilities are considered to be very much a part of the financial picture of any company. The likelihood of additional tax assessments is generally considered to be a "material contingent liability" of the sort that must be included in any SEC-mandated financial statement.

In the instant case, the Petitioner's counsel participated in the preparation of a report of these potential problems, and revealed certain items contained in this

tax pool analysis to the auditors. Significantly, the auditors did not receive any of the documents that made up the corpus of the analysis; they received only enough information to ensure compliance with SEC-mandated requirements for financial statements. Surely a company's own analysis of its tax situation and potential future tax liability is deserving of confidential treatment in such a situation, especially when the analysis has been prepared at the direction of its own legal staff as a means of estimating the likelihood of additional tax liability and future tax litigation or negotiation with the IRS. To permit, as the opinion of the court below does, the confidentiality of this information to be compromised based on what amounts to a necessary disclosure for purposes of compliance with other regualtory mandates can only lead to serious and unintended results. Corporate financial officers, aware that their discussions on tax issues with their own counsel may result in an unwitting loss of th privilege based on counsel's consultation with independent auditors, may well be very reluctant to give a full and accurate account of the company's tax situation to counsel. Counsel would then be left in the dark as to important factors, thereby rendering him incapable of giving reliable advice on this topic to his client. Similarly, should counsel possess such information, he or she will be reluctant to engage in even limited discussions with independent auditors for fear of triggering a complete waiver of the client's privilege. The end result could be less accurate financial statements, thereby undermining a central purpose of the securities laws.

The eventual outcome of this decision could well be less disclosure of a wide variety of salient facts to corporate counsel, the public, independent auditors, the SEC, and, eventually, the IRS. The holding of the court below must, as a result, be examined by this Court due to its potential impact on other laws and many companies throughout the economy.

CONCLUSION

In summary, the instant case presents this Court with an opportunity to resolve serious conflicts among the circuits in several important areas.

The standard of relevance under 26 U.S.C. § 7602 adopted by the court below is so broad as to make virtually any corporate document, whether tax-related or not, subject to the scrutiny of the IRS. This is not in keeping with precedents in other Circuits. Nor does it properly recognize this Court's efforts to delineate the bounds of the IRS' power to force disclosure of irrelevant information.

Secondly, the decision below seriously threatens to erode the attorney-client privilege, as enunciated by this Court in *Upjohn*. The privilege here has been lost due to the fact that some of the issues involved in the tax pool analysis were discussed with an independent auditor pursuant to efforts to comply with other federal laws. The fact that the court below has deemed the privilege lost as to these materials *in toto* even if the communication was confidential, essential for compliance with other laws, and where the materials were not related to the preparation of the questioned tax returns, makes this ruling so significant that it should have no further application without the specific approval of this Court.

This decision will be a source of confusion and uncertainty throughout the American business community. For these reasons, the Petition for the Writ of Certiorari should be granted.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

THE EL PASO COMPANY,
Petitioner,

v.

UNITED STATES OF AMERICA, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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BRIEF OF NATIONAL COAL ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

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BRIEF OF NATIONAL COAL ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

INTEREST OF AMICUS CURIAE

The National Coal Association ("NCA") is a trade association comprising approximately 200 members. Its coal producing members account for over 50 percent of the nation's coal production. In addition to coal producing companies, the National Coal Association's membership includes coal brokers, equipment suppliers, coal transporters, consultants, and resource developers.

Most of NCA's members are public companies subject to the financial reporting requirements of the federal securities laws. A number of NCA's members have their principal offices in, and/or conduct operations in, states

within the Fifth Circuit. Others have offices and/or operations in states within federal circuits whose decisions conflict with the decision below.

Regardless of where their offices or operations are located, all of NCA's public company members are affected by the uncertainty in the law arising from the inability of the courts of appeal to agree concerning the issues here involved. These companies must prepare, or have their outside accountants prepare, tax pool analyses so that their financial statements can be certified. The question whether, and under what circumstances, the Internal Revenue Service ("IRS") can summon these tax pool analyses pursuant to 26 U.S.C. § 7602 thus has a direct impact on them. It is in their interest, and in the interest of the public at large, that the courts settle upon a consistent and fair interpretation of the law on this recurring question. This Court's authoritative guidance is needed to resolve these conflicts, and this case provides an excellent vehicle for delivery of that guidance. It presents the issues on a fully developed record and in a clear and uncomplicated factual setting. The members of NCA therefore urge the Court to grant the El Paso Company's ("El Paso") petition for certiorari.[1]

CONSENT OF THE PARTIES

Both the Petitioner and Respondent in this case have consented to NCA's filing this brief as amicus curiae. The consents have been filed with the Clerk.

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[1] The members of NCA fully support El Paso's petition and request the Court to grant certiorari on both questions presented therein. It is NCA's aim in this brief to emphasize certain points regarding the tax pool analysis issues that it considers particularly important to its interests, rather than present a comprehensive argument on all issues. Accordingly, to the extent certain arguments (or statements of fact) included in El Paso's petition are not included in this brief, NCA adopts them as stated in El Paso's petition.

THE DECISION BELOW

The facts of this case as found in the district court and restated in the Fifth Circuit's decision make it clear that the reason El Paso's tax pool analysis has been summoned is not because the company is suspected of any wrongdoing or bad faith. To the contrary, the court below took pains to note that the audit was a routine audit of the type commonly conducted by the IRS on returns of major corporations. Appendix to El Paso's Petition for a Writ of Certiorari ("App.") at 2a. The IRS made its request for the tax pool analysis at the very outset of the audit, not because material it had reviewed put the tax pool analysis in issue, but rather because, as the court below put it, the analysis "may be useful to the IRS as a 'roadmap' through [the] company's tax return," (App. 28a) thereby focusing its energies. App. 12a.

Ordinarily, as is true in El Paso's case, a tax pool analysis is not used in any way to prepare the taxpayer's return. App. 6a. It is an evaluative, not factual, document prepared to assist the company in meeting its responsibilities under the securities laws. The analysis consists of both legal and non-legal judgments of the company's tax advisers on whether certain items on the company's tax returns will be challenged on audit, whether the company should litigate or settle particular issues, the likely outcome of litigation, the amount for which the company might be willing to settle a particular issue, and similar opinions and speculations.

The analysis is generally kept confidential by the taxpayer, and the independent auditor is required by ethical considerations to keep it confidential as well. The analysis itself is never submitted to the SEC. The company preparing it, or for which it is prepared, makes public in its financial statements only the bottom-line estimate of contingent liability (assuming the amount is material).

Companies ordinarily provide the facts necessary to an IRS audit in response to specific requests from the IRS. For instance, at the time of trial in El Paso's case the IRS had made some 578 requests for documents and information needed for the audit; El Paso had complied with over 98 percent of those requests.

REASONS FOR GRANTING CERTIORARI

I. This Court Should Review the Question Whether Tax Pool Analyses Are Privileged

The Second Circuit ruled in *United States v. Arthur Young*, 677 F.2d 211 (2d Cir. 1982), *petition for cert. filed*, 51 U.S.L.W. 3341 (U.S. Oct. 20, 1982) (No. 82-687), that a tax pool analysis sought by the IRS from the taxpayer's independent accountant was privileged and refused to enforce an IRS summons for the analysis. The court reached its decision after carefully balancing the IRS's need for the widest possible latitude in enforcing the internal revenue laws against the policy of the federal securities laws encouraging the fullest possible financial disclosure by public companies. 677 F.2d at 220. While acknowledging the importance of the IRS's interest in a broad summons power, the Second Circuit concluded that where the information necessary to completion of its audit was available to the IRS (and fraud was not charged), the public interest in accurate financial reporting outweighed the IRS's interest. *Id.* The court's principal concern was to protect the integrity of the auditor-client relationship so that public companies would be able to present a worst-case analysis of their contingent tax liability to their auditors without fear that the IRS would later turn this analysis against them. *Id.* at 221.

To ensure this protection the Second Circuit recognized a work product privilege for tax pool analyses that prevents the IRS from summoning such analyses from a taxpayer's independent accountant. The rationale of this

work product privilege applies with equal force to tax pool analyses prepared and maintained by the taxpayer. The harm to the integrity of the auditor-client relationship is no less when the confidences sought to be protected are extracted from the taxpayer rather than his accountant. The end result in both cases is to restrict the free flow of information vital to accurate financial reporting.

Despite the applicability of the *Arthur Young* privilege to the facts of this case, the Fifth Circuit's analysis of the privilege question made only passing reference to the *Arthur Young* decision, although it did acknowledge the disparity of views in a footnote. App. 19a n.13. Despite the tentative nature of this acknowledgement, it is clear that the two decisions are mutually contradictory and hence in direct conflict. If both decisions are allowed to stand, each will completely undercut the other with the result that the law will be determined for a particular company, not by reason, but by an accident of geography.

It is NCA's position that the decision below should not be permitted to stand. The Fifth Circuit's refusal to acknowledge the seriousness of the financial reporting issue (*see* App. 28a) prevented it from properly balancing that policy interest against the interest of the IRS in free access to financial information. The court's view was that public companies are required by law to file certified financial statements; it assumed that they would comply with the law and fully disclose their contingent tax liabilities regardless of the IRS summons policy. This view, however, is directly contradicted by the current commissioner of the IRS, Roscoe Egger, and at least one former commissioner, Mortimer Caplin. Egger, as discussed more fully below, has acknowledged the very real concerns of the SEC, professionals and the public for the quality of financial reporting as a result of the IRS summons policy. IRS News Release, IR 81-49, May 5, 1981, at 3. Caplin states that "[t]he policy arguments for

limiting the Service's access to accountants' tax accrual workpapers are persuasive * * *." *Government Access to Independent Accountants' Tax Accrual Workpapers*, 1 Va. Tax Rev. 57, 81-82 (1981).

The Government in the *Upjohn* case made an argument similar to the Fifth Circuit's in this case. *Upjohn Co. v. United States*, 449 U.S. 383, 393 n.2 (1981). It argued that there was no public policy reason to extend the attorney-client privilege to corporate self-investigations concerning improper foreign payments because the risk of civil or criminal liability would ensure that corporations would seek legal advice on the problem regardless of whether the privilege applied. This Court observed that while investigations might continue to take place, "the depth and quality of any investigations to ensure compliance with the law would suffer." *Id.* Similarly, while corporations may be expected to continue preparing tax pool analyses, their depth and quality will suffer if the IRS continues to summon them, with consequent adverse effect on the accuracy of financial statements.

The court below has also taken the position that El Paso waived the attorney-client privilege by disclosing parts of the analysis to its independent auditor, even though the disclosure was required by law and the auditor was required to keep the information disclosed confidential. AICPA Code of Professional Ethics, Rule 301. NCA submits that such a serious limitation on an important privilege merits this Court's attention. The Fifth Circuit decision on this question also conflicts with the Sixth Circuit's decision in *Upjohn*. *United States v. Upjohn*, 600 F.2d 1223, 1227 n.12 (1979), *rev'd on other grounds*, 449 U.S. 383 (1981), providing an additional reason for this Court to review the attorney-client privilege question. The Sixth Circuit there held that partial disclosures of privileged information amount to a waiver, assuming there is a waiver at all, only with respect to

the facts actually disclosed. *Id.* Both for reasons of this conflict and of the importance of the question, this Court should grant certiorari.

II. This Court Should Review the Question Whether Tax Pool Analyses Are Relevant Within the Meaning of 26 U.S.C. § 7602

The Tenth Circuit ruled in *United States v. Coopers & Lybrand*, 550 F.2d 615 (10th Cir. 1977) that a tax pool analysis is not relevant within the meaning of 26 U.S.C. § 7602 under ordinary circumstances. The court set out a number of factors to be weighed in determining if a tax pool analysis should be deemed relevant in a particular case. Applying these factors, it is clear that the analysis in this case would not be found relevant under the *Coopers & Lybrand* test. The Fifth Circuit, however, rejected the *Coopers & Lybrand* analysis and determined that any information which "might shed light" on the accuracy of the taxpayer's return was relevant within the meaning of section 7602. Under this sweeping standard, El Paso's tax pool analysis, as well as almost any other financial information the company may possess, would be deemed relevant.

In addition to the direct conflict with the *Coopers & Lybrand* decision, and the less direct, but nevertheless profound, conflict with the decision of the Eighth Circuit in *United States v. Matras*, 487 F.2d 1271 (8th Cir. 1973), a case presenting a relevance analysis similar to that in *Coopers & Lybrand*, this Court should review this issue because of the basic unfairness of the holding. As stated above, the IRS does not need tax pool analyses to complete its audit function; rather it seeks them for reasons of convenience and to "focus and concentrate [its] energy." App. 12a. While such concerns of efficiency are, of course, important, the IRS gains far more by summoning a taxpayer's tax pool analysis than mere information needed for completing an audit. It

learns from a tax pool analysis not only what areas the taxpayer considers fertile for review, but also what the taxpayer may accept in settlement on a particular issue, and whether the taxpayer would pursue its point of view in litigation, all without incurring any corresponding obligation to make a similar disclosure to the taxpayer. To permit one party to learn its opponent's negotiating and settlement positions in this fashion without extraordinarily strong policy reasons for so doing offends basic notions of good faith and fair play. For this reason, because of the above-noted conflicts, and because of the overall importance of the question, NCA urges this Court to grant certiorari on this issue.

III. This Case Presents the Tax-Pool-Analysis Issues in the Posture in Which They Are Most Likely To Recur

This case is unique among the circuit court decisions on the tax pool analysis issue in that El Paso's analysis was prepared completely in-house by its lawyers and other tax advisers and retained by El Paso. Consequently the IRS directed its summons to El Paso rather than to its independent accountant. In *Arthur Young* and *Coopers & Lybrand*, the other major circuit court decisions on the tax pool analysis question, the IRS had summoned the analysis from the taxpayer's independent accountant. Since the time the summonses were issued in those two cases, however, the IRS has amended its guidelines for revenue agents, articulating the circumstances in which tax pool analyses may be sought, and requiring agents to secure them from the taxpayer, rather than its independent auditor, whenever possible. I Internal Revenue Manual (Audit) (CCH) § 4024.4(5) (1981).[2]

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[2] In a speech announcing this change, IRS Commissioner Roscoe Egger noted the nationwide concern over the IRS policy of summoning tax pool analyses expressed by taxpayers, lawyers, accountants and the Securities and Exchange Commission. He said the change was made because of the potential of this policy to

As one of his reasons for seeking certiorari in the *Arthur Young* case, the Solicitor General has alluded to the frequently recurring nature of the tax pool analysis summons problem. Petition for Writ of Certiorari in *United States v. Arthur Young*, No. 82-687 at 7 (Oct. 20, 1982). Because of the change in the Internal Revenue Manual, however, it now appears that the issue will recur most frequently in the context of a summons directed to the taxpayer rather than his independent accountant. To resolve this issue fully, then, it would be best if the Court granted certiorari in both this case and *Arthur Young*. In any event, if the Court is to address the issue in the context in which it is most likely to recur, it should grant certiorari in this case, even if it does not grant it in *Arthur Young*.

CONCLUSION

For the reasons stated above, the Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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create "serious negative effects on the quality of financial reporting." IRS News Release, IR 81-49, Remarks by Roscoe L. Egger before the San Francisco Chapter of the California Institute of Certified Public Accountants and the Tax Section, San Francsico Bar Association, May 5, 1981, at 3. As at least one commentator has noted, however, the change in the IRS policy to requesting the analyses directly from the taxpayer only shifts the locus of the problem; it does not solve it. Buchholz, *Tax Accrual File Controversy: Legal Problems Facing the Accountant*, 40th Annual N.Y.U. Institute on Federal Taxation 37-1, 37-14 (1981).

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BRIEF OF TAX EXECUTIVES INSTITUTE, INC. AS AMICUS CURIAE IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

No. 82-716

THE EL PASO COMPANY,
Petitioner,

v.

UNITED STATES OF AMERICA, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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BRIEF OF TAX EXECUTIVES INSTITUTE, INC. AS AMICUS CURIAE IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

INTEREST OF THE AMICUS CURIAE

Pursuant to Rule 36 of the Rules of this Court, Tax Executives Institute, Inc. respectfully submits this brief as *amicus curiae* to urge this Court to grant The El Paso Company's petition for a writ of certiorari in this case.[1]

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[1] Tax Executives Institute has requested and received the written consent of all parties to the filing of this brief, which consents are filed herewith.

Amicus Tax Executives Institute, Inc. (TEI) is a voluntary, nonprofit association of corporate and other business executives, managers, and administrators who are responsible for the tax affairs of their employers. The Institute was organized in 1944 and currently has approximately 3700 members from more than 1100 of the leading corporations in the United States and Canada. TEI is dedicated to promoting the uniform and equitable enforcement of tax laws throughout the nation and to reducing the costs and burdens of administration and compliance to the benefit of both the government and taxpayers. Among the standards of professional conduct that all TEI members subscribe to is the following, which bears directly on the central issue raised by the decision of the court below:

> The member will present the facts required in tax returns and all the facts pertinent to the resolution of questions at issue with representatives of the government imposing the tax.

TEI Standards of Conduct, *reprinted in* Tax Executives Institute, Inc., *Thirty Years for the Profession* 25 (1974).

TEI members have a vital interest in the resolution of the "tax accrual workpapers" issue addressed by the court below. Substantially all TEI members are employed by corporations that are subject to federal securities laws, compliance with which requires the preparation of tax accrual workpapers or similar documents. Consequently, TEI members almost without exception are involved in the preparation or review of tax accrual workpapers. TEI is understandably concerned about the Internal Revenue Service's attempts to obtain such workpapers, which are nonfactual in nature and consist of theories, hypotheses, opinions, and speculations regarding contingent tax liabilities. In particular, TEI believes that, unless reversed by this Court, the decision below would not only erode the protections afforded taxpayers by section

7604 of the Internal Revenue Code of 1954, as amended,[2] and elaborated on by this Court in *United States v. Powell*, 379 U.S. 48 (1964), but would also undermine certain policies underlying the federal securities law (specifically, the maintenance of fair and honest securities markets).

Amicus Tax Executives Institute, as the principal association of corporate tax executives and managers, believes prompt review by this Court of the decision below is necessary to achieve a proper balance of the competing policy interests and to provide taxpayers and the Internal Revenue Service alike with guidance on the scope of the Service's summons power under section 7602. TEI accordingly supports The El Paso Company's petition for a writ of certiorari.

REASONS FOR GRANTING THE WRIT OF CERTIORARI

I.

Nearly two decades ago this Court was called upon to articulate the requirements for enforcement of a summons issued under section 7602 of the Code. In *United States v. Powell*, 379 U.S. 48 (1964), the Court forthrightly answered that call and held that in order for such a summons to be enforced—

> [The Internal Revenue Service] must show that the investigation will be conducted pursuant to a legitimate purpose, that the inquiry may be relevant to the purpose, that the information sought is not already within the Commissioner's possession, and that the administrative steps required by the Code have been followed * * *.

Id. at 57-58. In addition, the Court in *Powell* made it clear that section 7602 is not self-executing and that the federal courts have an important role to play in en-

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[2] Unless otherwise noted, all references to sections are to the Internal Revenue Code of 1954, as amended (I.R.C.), which is codified at title 26 of the United States Code.

suring that the Service exercises its summons authority in good faith. *Id.* at 58. *See also United States v. Bisceglia*, 420 U.S. 141, 151 (1975) (the Internal Revenue Service's summons power "is a limited power and should be kept within its proper bounds").[3]

This Court granted certiorari in *Powell* "[b]ecause of the differing views in the circuits on the standards the Internal Revenue Service must meet to obtain judicial enforcement of its orders * * *." 379 U.S. at 50-51 (footnote omitted). Unfortunately, with respect to tax accrual workpapers and similar documents,[4] the uncertainty the Court sought to dispel in *Powell* remains. The courts of appeals are badly divided on this issue, both on the result that should obtain when a summons is issued for such nonfactual information and on the rationale that should be used in determining whether to enforce such a summons. Specifically, the Tenth Circuit in *United States v. Coopers & Lybrand*, 550 F.2d 615 (10th

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[3] In *Bisceglia* this Court explained that the purpose of section 7604 is to provide "protection from arbitrary and capricious action by placing the federal courts between the Government and the person summoned." *Id.*

[4] Tax accrual workpapers, which are also variously referred to as "tax pool analysis," "tax accrual files," "tax cushion," and "tax liability contingency analysis," comprise a company's theories, opinions, arguments, and speculations about its contingent tax liabilities. The workpapers are not prepared in connection with the preparation of the company's tax returns. Rather, they are prepared, either by the company's own tax personnel or by independent outside accountants, to assist the company in satisfying its legal responsibilities under federal securities laws. Specifically, the tax accrual workpapers are used by the company's accountants in preparing audited financial statements in accordance with generally accepted accounting principles; those principles require, among other things, that provision be made for material contingent liabilities (ranging from the probable to the highly remote), including tax liabilities that might be reasonably incurred in negotiating settlements of proposed audit adjustments so that extended litigation can be avoided. *See* 15 U.S.C. § 78*l* (1976); Regulation S-X, 17 C.F.R. §§ 210, *et seq.* (1981).

Cir. 1977), held that a summons seeking access to tax accrual workpapers is not enforceable under section 7604 because such documents are not relevant to the taxpayer's tax liability. The Eighth Circuit in *United States v. Matras*, 487 F.2d 1271 (8th Cir. 1973), reached the same result in respect of quite analogous documents. Taking a different approach, the Second Circuit in *United States v. Arthur Young & Co.*, 677 F.2d 211 (2d Cir. 1982), *petition for cert. filed*, 51 U.S.L.W. 3341 (U.S. Oct. 20, 1982) (No. 82-687), recently concluded that tax accrual workpapers are relevant under section 7602; the court found, however, that public policy required that a summons for such documents ordinarily not be enforced, and accordingly it fashioned a work-product privilege that, in the absence of allegations of fraud, will shield the documents from disclosure. The court below, of course, held both that Petitioner's tax accrual workpapers were relevant to the Service's audit and that the work-product privilege had no application to such documents; moreover, the court below held that any attorney-client privilege that might have existed with respect to tax accrual workpapers prepared under the supervision of an attorney was waived when the workpapers were disclosed to Petitioner's accountants.

Clearly, a conflict exists over whether and why the Internal Revenue Service should be denied access to tax accrual workpapers. The conflict is attributable to the differing views the courts of appeals have respecting the government's interest "in the enforcement of its laws and collection of the revenues," *Couch v. United States*, 409 U.S. 322, 336 (1973), and the "national public interest • • • [in] insur[ing] the maintenance of fair and honest markets in [securities] transactions," 15 U.S.C. § 78b (1976). *See United States v. Arthur Young & Co.*, 677 F.2d at 219. Guidance from this Court is needed to resolve how these policy interests are to be weighed. Accordingly, the writ of certiorari should be granted pursuant to Rule 17.1(a) of the Rules of this Court.

It is respectfully submitted, moreover, that in resolving the conflict among the courts of appeals, this Court should articulate guidelines that can be applied regardless of the factual setting in which the tax accrual workpapers issue arises. The policy question that this case poses is whether nonfactual documents prepared to ensure compliance with the securities law and not in connection with preparation of tax returns should, absent allegations of fraud, be subject to a summons issued under section 7602 of the Code. *Amicus* Tax Executives Institute submits that the proper answer to that question is no, and consequently that the decision of the court below should be reversed.

Whatever balance is struck in this case, it is essential that a uniform rule be established. Obviously, the resolution of this issue should not depend on which circuit a suit to enforce a summons is brought in. Nor should the result turn on whether the tax accrual workpapers are prepared by or are in the possession of independent outside accountants rather than the company's own personnel or on their being prepared by or under the supervision of a lawyer. The need for nondisclosure—to ensure both the independence of the auditing process and the high quality of financial reporting—is compelling regardless of who prepares or possesses the workpapers. Consequently, this Court should generally hold that, in the absence of allegations of fraud, tax accrual workpapers are not subject to disclosure under section 7602 of the Code.[6]

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[6] Because a majority of its members are not lawyers or employed by companies whose tax departments are headed by lawyers, *amicus* TEI is concerned that reversal of the court below on the attorney-client privilege issue alone, while certainly proper in light of this Court's decision in *Upjohn Co. v. United States*, 449 U.S. 383 (1981), would not provide the necessary guidance to the majority of corporate taxpayers, which rely on accountants to prepare or supervise the preparation of tax accrual workpapers. Similarly, a simple affirmance of the Second Circuit's decision in *Arthur Young*, with-

II.

The court below held that Petitioner's tax accrual workpapers were relevant to the Internal Revenue Service's audit. That holding is directly at odds with the Tenth Circuit's holding in *Coopers & Lybrand* and with the reasoning of the Eighth Circuit in *Matras*. In reaching their contrary results, the courts of appeals applied different standards of relevance, and guidance from this Court is necessary to resolve the conflict.

In finding tax accrual workpapers to be relevant under section 7602, the court below applied the test for relevance first articulated by the Second Circuit in *Foster v. United States*, 265 F.2d 183 (2d Cir.), *cert. denied*, 360 U.S. 912 (1959), namely, that a summons satisfies the relevance test if it seeks information that "might throw light upon the correctness of the taxpayer's returns." 265 F.2d at 187; *United States v. El Paso Co.*, 682 F.2d 530, 537 (5th Cir. 1982); *accord United States v. Arthur Young & Co.*, 677 F.2d at 218. Although acknowledging that tax accrual workpapers are not prepared to assist in filling out tax returns but rather only for financial reporting purposes, 682 F.2d at 534-35, the court below concluded that the documents are relevant because they tend to "focus and concentrate the Service's energy on questionable positions in the return * * *." 682 F.2d

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out making it clear that the work-product privilege fashioned by the court applies with the same force to tax accrual workpapers prepared and maintained by a taxpayer's own personnel as it does to workpapers prepared and maintained by outside accountants, would do little to end the confusion and uncertainty that marks this area. TEI recognizes that this Court "sit[s] to decide concrete cases and not abstract propositions of law * * *." *Upjohn Co. v. United States*, 449 U.S. at 386. Consistent with the view that the Court has a "special duty" to provide guidance, *id.* at 403 (Burger, C.J., concurring), however, TEI respectfully suggests that the tax accrual workpapers issue be addressed in such a way that all taxpayers who, to ensure compliance with the securities laws, prepare or make use of such workpapers, as well as the government, know the limits of the Internal Revenue Service's summons power.

at 537. *Amicus* Tax Executives Institute respectfully submits that the standard of relevance applied by the court below is unreasonably broad.

This Court, of course, has never directly addressed the propriety under section 7602 of the "might throw light" standard of relevance. Several circuits, however, have expressed reservations about that standard and especially about the dangers of adopting too broad an interpretation of the term. For example, the Second Circuit in *United States v. Harrington*, 388 F.2d 520 (2d Cir. 1968), held that even under *Foster* (which that court decided) a summons will not be enforced unless there is "an indication of a realistic expectation rather than an idle hope that something may be discovered." *Id.* at 524; *accord United States v. Bisceglia*, *supra*, 420 U.S. at 151 (section 7602 does not authorize a "fishing expedition" by the Service); *United States v. Theodore*, 479 F.2d 749, 754 (4th Cir. 1973) (same). A similar concern was voiced by the Eighth Circuit in *United States v. Matras*, *supra*, where the Service issued a summons for the taxpayer's proposed budgets—"only a projection of what the actual transactions would be," 487 F.2d at 1272—on the ground that they would be useful as a "road map as to where we want to go." *Id.* at 1273. The Eighth Circuit refused to enforce the summons. In doing so, the court first explained that "[t]he term 'relevant' connotes and encompasses more than 'convenience.'" *Id.* at 1275. Then, it added:

> Consequently, we are not persuaded to fault the district judge for concluding that the government failed to sustain its burden of proof by alleging a general need for a "road map." If we were to accede to the government's view, it is difficult to imagine corporate materials that might not contribute to a more comprehensive understanding of the workings of the corporation, and thus, according to the government, be deemed relevant to the tax investigation.

Id.

The policy reasons for not adopting the Service's proposed definition of relevance were further elaborated on by both the district court and the Tenth Circuit in *United States v. Coopers & Lybrand*, *supra*, which specifically involved tax accrual workpapers. In that case, the Tenth Circuit cited *Matras* with approval and then agreed with the trial court that tax accrual workpapers, like the proposed budgets in *Matras*, are not relevant for section 7602 purposes. The court of appeals reasoned, as follows:

> [E]xtending IRS contentions herein to their logical conclusion, it is hard to determine what corporate records would not fall under a § 7602 summonses [*sic*] if the standard endorsed the production of *any* records which *might* show tax fraud or tax liability. IRS does not, as it appears to assume on this appeal, have *carte blanche* discovery.

550 F.2d at 619 (emphasis in original), *aff'g* 413 F. Supp. 942, 946-49 (D. Colo. 1975) (several factors must be weighed in deciding whether tax accrual workpapers are relevant, including the adverse effect disclosure might have on the interchange between the taxpayer and its independent accountants and any resulting weakening of the securities laws).

The Eighth Circuit in *Matras* and the Tenth Circuit in *Coopers & Lybrand* properly concluded that application of too open-ended a definition of "relevance" would constitute an abdication of the courts' supervisory responsibility under section 7604. The court below obviously reached the contrary conclusion. This Court should grant certiorari to consider whether the decision of the court below effectively eviscerates the protections afforded by section 7604 and, consequently, whether the Tenth and Eighth Circuits' decisions to keep the Service's summons power "within its proper bounds" (*United States v. Bisceglia*, *supra*, 420 U.S. at 151) were appropriate.

Amicus Tax Executives Institute respectfully urges this Court to hold that the "realistic expectation rather than an idle hope" standard of *Harrington* is an integral part of section 7602 and, moreover, that absent allegations of fraud, nonfactual materials (such as tax accrual workpapers) are not relevant and thus not subject to the Service's summons power.[6] Limiting the definition of relevance to factual materials (except perhaps in those cases involving allegations of fraud where the taxpayer's state of mind would be at issue) would not only be eminently sensible but would give fresh significance to the protections afforded by section 7604.[7]

III.

The court below found that no work-product privilege shielded Petitioner's tax accrual workpapers from disclosure. That conclusion conflicts with the Second Circuit's decision in *Arthur Young*, where the court held that the policies underlying federal securities laws required that a work-product privilege be fashioned to preserve "the integrity of the auditing process." 677 F.2d at 221, *citing Hickman v. Taylor*, 329 U.S. 495, 512-13 (1947). Thus, although concluding that tax accrual workpapers were relevant under its expansive reading of section 7602, the Second Circuit ultimately struck the same balance between the competing interests as the

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[6] *Cf. P.T. & L. Construction Co. v. Commissioner*, 63 T.C. 404, 414 (1973), in which the Tax Court explained: "What is relevant [under the Tax Court's discovery rules] is the *factual information* which may either reveal evidence that will be admissible at the trial or lead to the discovery of such evidence. Mental impressions, legal analysis, conclusions, and recommendations are generally not relevant." (Emphasis in original.)

[7] In addition to providing guidance on the relevance standard to be applied, the Court might well consider whether a summons for tax accrual workpapers issued at the outset of an audit before any specific issues are identified could ever satisfy the good faith requirement of *Powell*. *See* note 8 *infra*.

Tenth Circuit did in *Coopers & Lybrand*. The *result* reached by the court below, then, conflicts not only with the result in *Coopers & Lybrand* but also with the result in *Arthur Young*. This Court should grant certiorari and reverse the court below, thereby confirming that the strong national interest underlying the securities laws justifies shielding tax accrual workpapers from disclosure under section 7602. *See United States v. Arthur Young & Co.*, 677 F.2d at 219 (summonses are not to be mechanically enforced; countervailing national policy can undercut broad latitude otherwise provided to the Service), *citing United States v. Euge*, 444 U.S. 707, 715-16 & n.9 (1980).

Amicus Tax Executives Institute respectfully submits that the strong public interest in maintaining the high level of financial reporting ordinarily far outweighs the Service's "need"—for convenience' sake—for a "road map." Consequently, to prevent that public interest from being undermined, the Service should, absent allegations of fraud, be denied access to tax accrual workpapers. The court below, of course, concluded almost cursorily that it was "wholly speculative" to state that the compelled disclosure of tax accrual workpapers would undermine the securities laws. 682 F.2d at 544. That conclusion is contrary not only to that reached by the Second Circuit in *Arthur Young*, 677 F.2d at 220 & n.9, *citing Upjohn Co. v. United States*, *supra*, 449 U.S. at 393 n.2, but also to the views of the current Commissioner of Internal Revenue, Roscoe L. Egger, Jr., who has remarked that a Service policy of routinely seeking tax accrual workpapers—a policy the decision of the court below implicitly supports—"had real potential for serious negative effects on the quality of financial reporting." Internal Revenue News Release, IR-81-49, Remarks by Roscoe L. Egger, Jr., Commissioner of Internal Revenue, Before the Joint Meeting of the San Francisco Chapter of the California CPA Society and the Tax Section, San Francisco Bar Association, San Francisco, California,

May 5, 1981.[8] This Court should consider whether the policy considerations that led to its decision in *Upjohn* should similarly lead to the recognition of a work-product privilege in respect of tax accrual workpapers.[9]

IV.

Shortly after the court below rendered its decision in this case, Congress enacted legislation that at a minimum circumscribes and that arguably vitiates entirely the Service's authority to seek tax accrual workpapers under section 7602 of the Code. Section 323(a) of the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324 (to be codified at section 6661 of the Code, 26 U.S.C. § 6661), provides a penalty for substantial underpayments of tax. That penalty is to be forgiven, however, to the extent the underpayment is attributable to items with respect to which the relevant facts are adequately disclosed on the taxpayer's return.[10] Thus,

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[8] Commissioner Egger's remarks were followed shortly by a revision of the Service's rules for requesting tax accrual workpapers. Under the amended rules (which are found in section 4024 of the Internal Revenue Manual), an examiner is not to request tax accrual workpapers until (1) the tax examination is substantially completed, (2) specific issues are identified, and (3) the taxpayer (and his accountant) are requested to provide all known *facts* that relate to the identified issues. I Internal Revenue Manual—Audit (CCH) § 4024 (1981). Given the Service's recognition of the need to preserve the high quality of financial reporting and its own apparent doubts about the propriety of routinely seeking tax accrual workpapers, it would seem appropriate for this Court to address whether, under a proper reading of the good faith requirement of *Powell*, compliance with the revised procedures is required under section 7602.

[9] A decision that tax accrual workpapers are not relevant under section 7602, of course, would obviate the need for this Court to consider the privilege question.

[10] I.R.C. § 6661(b)(2)(B)(ii). The penalty is also forgiven if the taxpayer has "substantial authority" for its position. I.R.C. § 6661(b)(2)(B)(i). Different rules apply in respect of tax shelters. I.R.C. § 6661(b)(2)(C).

Congress has passed legislation that encourages the disclosure of positions for which the taxpayer does not have substantial authority.

There is concededly no statutory link between new section 6661 and the Service's authority to issue summonses under section 7602. It cannot be denied, however, that the new provision is related to the Service's efforts to secure tax accrual workpapers. Indeed, in refusing to enforce the summons in *Arthur Young*, the Second Circuit specifically referred to such a provision (then in its nascent stages), as follows:

> In reaching this conclusion [not to enforce the summons], we are comforted by the knowledge that if Congress feels that this privilege unduly restricts the IRS's authority, it can require that this material be made available, or that taxpayers flag their questionable positions directly on their returns, in line with the suggestions of former Commissioner Kurtz, 32 Tax Law. [13,] at 15-16 [1978]; Cooper, The Avoidance Dynamic: A Tale of Tax Planning, Tax Ethics, and Tax Reform, 80 Colum. L. Rev. 1553, 1612 (1980). Procuring tax accrual workpapers under § 7602 seems to us to effectuate Commissioner Kurtz's proposals through the back door.

677 F.2d at 221.

Almost as if in response to the Second Circuit's invitation, Congress enacted section 6661. That provision affords taxpayers a choice of two means by which the substantial underpayment penalty can be avoided—either by having substantial authority for the positions taken on the return or by disclosing the relevant facts in respect of those positions. If not reversed, however, the decision of the court below could well present taxpayers with nothing more than a Hobson's choice under section 6661, for disclosure would occur in all events—either on the return (pursuant to new section 6661) or during the

audit (in response to a summons). That result, it is submitted, would be fundamentally at odds with Congress's intent in enacting section 6661.

Stated differently, section 6661 carefully prescribes what the taxpayer should disclose (essentially, the relevant facts relating to positions for which there is not substantial authority) and the consequences of not doing so (the underpayment penalty). It defines, quite simply, the type of limited "road map" taxpayers must provide to the Service. To borrow the Second Circuit's analogy, having been told what information it can obtain through the "front door" (the tax return and supporting factual information), the Service should properly now be precluded from obtaining additional information through the "back door" (the summons). This Court should grant certiorari to clarify precisely the extent to which new section 6661 limits the Service's authority under section 7602.

CONCLUSION

For the foregoing reasons, this Court should grant the petition for a writ of certiorari and reverse the decision of the court below.

Respectfully submitted,

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